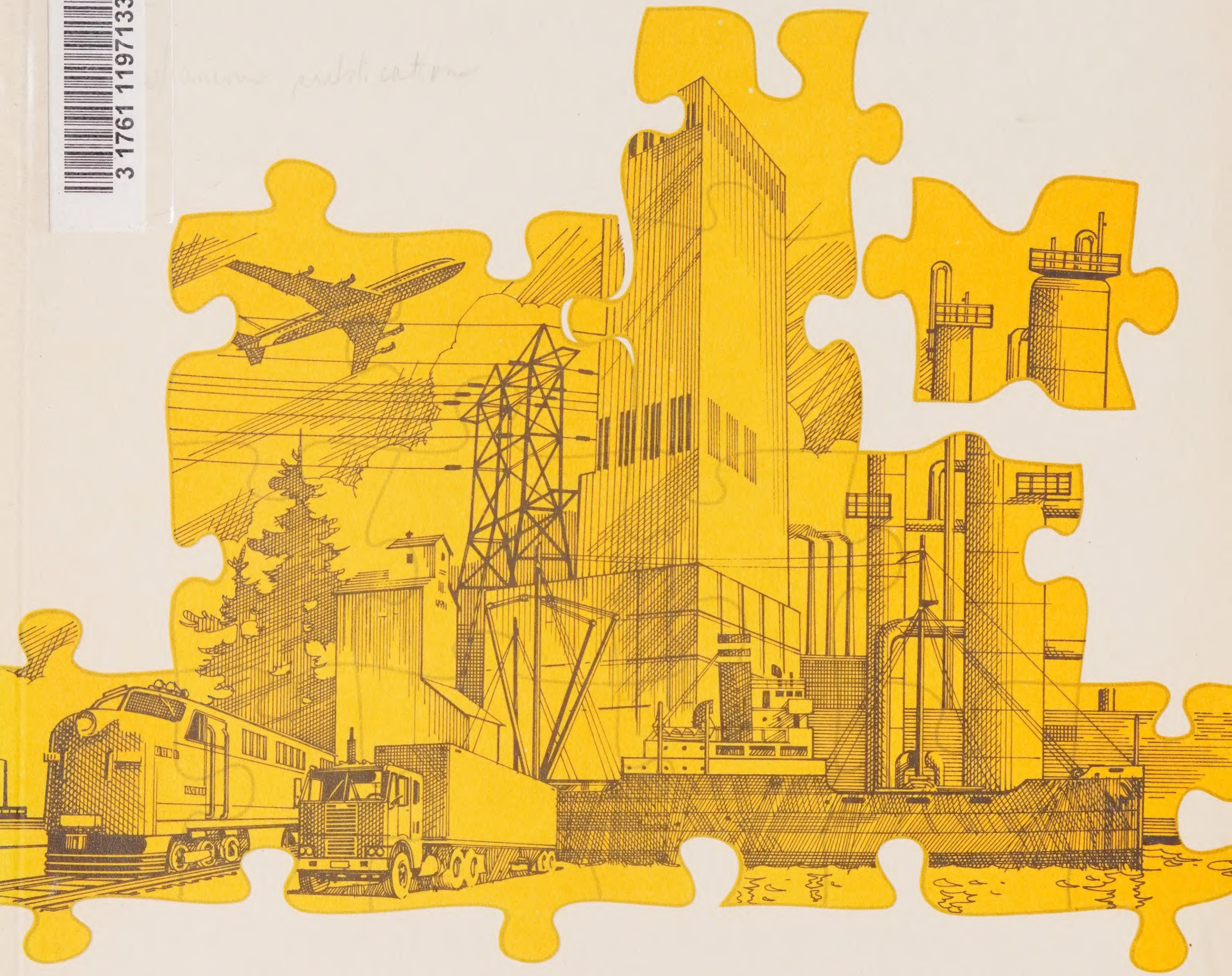
Royal Commission on Corporate Concentration



STUDY NO. 24

# Reciprocal Buying Arrangements: A Problem in Market Power?

A Technical Report

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# Reciprocal Buying Arrangements: A Problem in Market Power?

## A Technical Report

by

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# FOREWORD

In April 1975, the Royal Commission on Corporate Concentration was appointed to "inquire into, report upon, and make recommendations concerning:

(a) the nature and role of major concentrations of corporate power in Canada;

(b) the economic and social implications for the public interest of such concentrations; and

(c) whether safeguards exist or may be required to protect the public interest in the presence of such concentrations."

To gather informed opinion, the Commission invited briefs from interested persons and organizations and held hearings across Canada beginning in November 1975. In addition, the Commission organized a number of research projects relevant to its inquiry.

This study surveying the Canadian and U.S. literature and empirical evidence on reciprocal buying arrangements is one of a series of background studies prepared for the Commission. It was researched and written by William T. Stanbury, Professor of Policy Analysis in the Faculty of Commerce and Business Administration, University of British Columbia. Dr. Stanbury is author of several articles in the area of competition policy, and spent the 1975-76 academic year doing research on that topic under contract to the federal Department of Consumer and Corporate Affairs. This study was, however, prepared under the direction and sponsorship of the Commission

The Commission is publishing this and other background studies in the public interest. We emphasize, however, that the analyses presented and conclusions reached are those of the author, and do not necessarily reflect the views of the Commission or its staff.

Donald N. Thompson
Director of Research

ACKNOWLEDGEMENTS

I am indebted to Dr. Donald Thompson, Director of Research of the Royal Commission on Corporate Concentration, for proposing that I study the issue of reciprocal buying arrangements. Tom Gallagher, a former student in his final year of law at the University of British Columbia, worked hard to assemble several thousand pages of cases, consent decrees, articles and books for modest remuneration. His paper, "Reciprocity: A Recent Development in American Antitrust Law," prepared under my direction and that of Professor Richard Gosse, helped greatly in the preparation of Chapter 6. Dr. Rob and Ms. Alison Masson of the U.S. Department of Justice and Federal Trade Commission respectively, graciously arranged for interviews with senior officials in those agencies who agreed to discuss U.S. policy toward reciprocal dealing. Paul Gorecki of the Bureau of Competition Policy and my colleague Bill Waters each kindly gave up several hours to discuss a variety of issues in Chapter 5. Staff of the Royal Commission assisted in typing the rough drafts of several chapters. The remainder were efficiently typed by two members of the support staff of the Faculty of Commerce and Business Administration. Mrs. Beth Ediger edited the manuscript for publication and suggested many useful changes aimed at improving the technical consistency and readability of the text. Financial support for the study was provided by the Royal Commission on Corporate Concentration.

To all of those who assisted me in the course of the work I express my sincere appreciation. All defects are the responsibility of the author.

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October 1976

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# CHAPTER 1

## INTRODUCTION

This study examines the question, "To what extent does the practice of reciprocity by business firms constitute an economically significant restraint of trade?" Although there are somewhat different interpretations of the term, at this point we can say that reciprocity refers to trade between firms when the potential volume of one firm's purchases from others induces those others to buy from it. Reciprocal dealing ranges from a mutually convenient exchange of inputs and outputs between firms to what has been called coercive reciprocity. In the latter, the dominant firm in the "partnership", usually on the basis of its purchasing power, uses threats or pressure to induce its suppliers to buy its output.

The evaluation, in terms of public policy, of reciprocal dealing by business firms is made difficult by the fact that it often represents a specific manifestation of a deeply ingrained social norm. Compare the words of Cicero with those of a contemporary American businessman:

> There is no duty more indispensable than that of returning a kindness...all men distrust one forgetful of a benefit. - Cicero[1]

> We are normally obligated to consider those people who have befriended us in the matter of purchases...we feel it just as important to emphasize the fact that when we need help we should feel free to call upon our commercial friends to help us in the matter of our sales, just as we have helped them.[2] (Director of Trade Relations, Jones & Loughlin Steel Corp., 1960)

The sociologist Alvin Gouldner, after an extensive survey of the sociological and anthropological literature, arrived at the following conclusions:

> Contrary to some cultural relativists, it can be hypothesized that a norm of reciprocity is universal. As Westermarck stated, "To requite a benefit or to be grateful to him who bestows it, is probably everywhere, at least under certain circumstances, regarded as a duty." A norm of reciprocity is, I suspect, no less universal and important an element of culture than the incest taboo, although, similarly, its concrete formulations may vary with time and place.[3]

But how do we reconcile the cultural norm of reciprocity with allocation of scarce resources through the use of impersonal markets?

The theory of universal, smoothly functioning, competitively structured markets holds that free exchanges of goods and services for money expresses the totality of the transaction. The acquisition of goods is fully requited by the transfer of money. Each transaction in the cash nexus is independent of all other transactions. Buyers and sellers have no memory, except for prices, which in a world of pefect information (or at least imperfect information universally available at similar costs) and homogeneous goods, embody all relevant information for both buyer and seller. In such markets, loyalty, sentiment, and history are non-existent--or at least completely irrelevant. Since each seller can sell all his production at the going or market price, a buyer's previous purchases are completely unimportant. And, since each buyer can buy all he wants at the market price (which is known to all), past sales to him by a specific producer are also irrelevant. Joel Dean epitomizes the traditional economist's view when he states:

> Continuing reciprocation makes economic sense only when both parties sell in imperfectly competitive markets. If I were selling wheat, I should do no favors to the baker who bought that wheat at the going price.[4]

Ferguson, on the other hand, is not so strict, for he says:

> A firm without market power may ask his suppliers to purchase from him; such reciprocity constitutes a sales promotion device and should be treated as such. If the firm offers to sell at prices equal to those available elsewhere, his suppliers might be willing to buy from him as long as the price conditions persist.[5]

In Chapter 5, we explore in some detail the conditions under which reciprocal dealing is most likely to occur and the economic significance (pro- and anti-competitive) of such dealing in the markets touched by it. In general, reciprocity is only a matter of concern to public policy makers (specifically those charged with the responsibility for competition policy) when firms have otherwise unutilized market power and that power in dealing with firms in other imperfectly competitive markets.

Canada does not now have, nor has it had any legislation with respect to reciprocal dealing. Therefore, we must turn to the experience of the United States to try to assess the extent to which reciprocity constitutes a problem in market power.

As a <u>significant</u> issue in antitrust policy in the United States reciprocity cases began to emerge only in the 1960's. As Table 1 indicates, the Federal Trade Commission prosecuted three cases in the 1930's. These cases, all successful for the FTC, dealt with coercive reciprocity, and the practice was attacked under Section 5 of the Federal Trade Commission Act which

TABLE 1

A CHRONOLOGY OF RECIPROCITY DECISIONS

| Year | Federal Trade Commission | | Justice Department | | Private |
|---|---|---|---|---|---|
| | Contested | Consent Decree | Contested | Consent Decree | |
| 1931 | Waugh Equipment | | | | |
| 1932 | Mechanical Mfg. | | | | |
| 1937 | California Packing | | | | |
| 1963 | | | Ingersoll-Rand | | |
| 1965 | Consolidated Foods* | | Penick & Ford | | |
| 1966 | | | General Dynamics | | |
| 1969 | | | Northwest Ind. ITT (Hartford) | United States Steel, R.J. Reynolds | Allis-Chalmers v. White Consol. |
| 1970 | | | ITT (Grinnell) | General Tire, Inland Steel, Republic Steel, Armco Steel, PPG Industries, Bethlehem Steel, Ling-Temco-Vought | |
| 1971 | | | White Consol. & White Motor | Evans Products, | Columbia Nitrogen v. Royster |
| | | | | Kennecott Copper, National Steel, Alcoa, Reynolds Metal | |
| | | | ITT (Canteen) | ITT (Canteen), ITT (Grinnell) ITT (Hartford), American Standard, Swift, Armour, Wilson & Cudahy | |
| 1972 | | | | Jacksons Concrete, Owens-Illinois, W.R. Grace, Martin Marietta, H.K. Porter, Westinghouse, Uniroyal, TIME-D.C. (freight) | |
| 1973 | | | | Yellow Freight, Crane, United Aircraft | Stavrides v. Mellon |
| 1974 | | Occidental Pet. & Diamond Shamrock Southlands Corps. | Airco | | W.R. Gore v. Carlisle |
| | | | | Continental Can | Carlson v. S & H Co. |
| | | | | Grow Chemical | |
| 1975 | | | | | Fidelity TV: RKO |

* Supreme Court Decision, original decision by the FTC occurred in 1963.

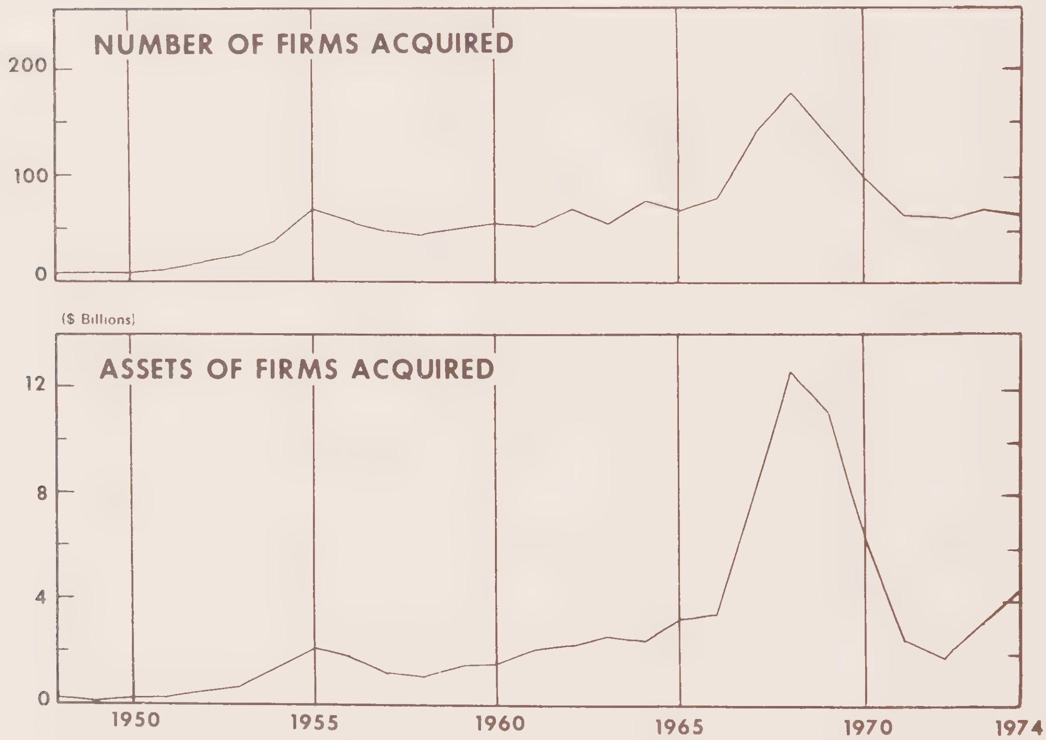
is concerned with unfair trade practices. (See Appendix A.) Between the California Packing case, decided in 1937, and 1963, when the FTC announced its decision in Consolidated Foods, there were no prosecutions or consent decrees relating to reciprocal dealing.

Reciprocity as an antitrust issue arose out of the concern over conglomerate mergers. Not only did total merger activity increase sharply in the late 1960's, but conglomerate mergers accounted for an increased proportion of all mergers. The volume of merger activity in terms of firms acquired with assets of $10 million or more is depicted in Chart 1. It is obvious that both the number and value of assets of such large mergers increased enormously between 1965 and 1968 and then declined just as precipitously, so that in 1972 the level of merger activity was below the 1965 level. (Table 2 provides additional details.)

CHART 1

LARGE* MANUFACTURING AND MINING FIRMS ACQUIRED

1948 - 1974




*Firms with assets of $10 million or more.

SOURCE: Bureau of Economics, Federal Trade Commission.

Source: Bureau of Economics, FTC Statistical Report on Mergers and Acquisitions, Washington, D.C., October 1975, p. 113.

TABLE 2

LARGE ACQUISITIONS IN MANUFACTURING AND MINING BY FIRMS RANKED AMONG THE 200 LARGEST MANUFACTURING FIRMS IN 1973, BY YEAR, 1948-1974

| | Total Large Acquisitions [1] | | Large Acquisitions by 200 Largest Firms [2] | | Percentage of Total Large Acquisitions by 200 Largest Firms | | |
|---|---|---|---|---|---|---|---|
| Year | Number | Assets (Millions) | Number | Assets (Millions) | Number | Assets | Acquired Assets As Percent of New Investment |
| 1948 | 4 | $ 63.2 | 4 | $ 63.2 | 100.0 | 100.0 | 1.1 |
| 1949 | 6 | 89.0 | 4 | 45.3 | 66.7 | 50.9 | 1.1 |
| 1950 | 5 | 186.3 | 1 | 20.0 | 20.0 | 10.7 | 2.3 |
| 1951 | 9 | 201.5 | 6 | 160.1 | 66.7 | 79.5 | 1.7 |
| 1952 | 16 | 373.8 | 7 | 195.0 | 43.8 | 52.2 | 3.0 |
| 1953 | 23 | 779.1 | 11 | 468.1 | 47.8 | 60.1 | 6.1 |
| 1954 | 37 | 1,444.5 | 15 | 930.2 | 40.5 | 64.4 | 11.8 |
| 1955 | 67 | 2,168.9 | 32 | 1,199.5 | 47.8 | 55.3 | 16.9 |
| 1956 | 53 | 1,882.0 | 29 | 1,271.5 | 54.7 | 67.6 | 12.4 |
| 1957 | 47 | 1,202.3 | 20 | 703.7 | 42.6 | 58.5 | 7.8 |
| 1958 | 42 | 1,070.6 | 18 | 682.1 | 42.9 | 63.7 | 8.5 |
| 1959 | 49 | 1,432.0 | 18 | 752.9 | 36.7 | 52.6 | 12.2 |
| 1960 | 51 | 1,535.1 | 21 | 789.4 | 41.2 | 51.4 | 10.6 |
| 1961 | 46 | 2,003.0 | 20 | 1,453.5 | 43.5 | 72.6 | 14.2 |
| 1962 | 65 | 2,241.9 | 26 | 1,065.1 | 40.0 | 47.5 | 16.0 |
| 1963 | 54 | 2,535.8 | 32 | 1,810.9 | 59.3 | 71.4 | 17.8 |
| 1964 | 73 | 2,302.9 | 32 | 1,066.7 | 43.8 | 46.3 | 12.3 |
| 1965 | 62 | 3,232.3 | 24 | 1,950.3 | 38.7 | 60.3 | 14.5 |
| 1966 | 75 | 3,310.7 | 28 | 1,913.2 | 37.3 | 57.8 | 12.9 |
| 1967 | 138 | 8,258.5 | 58 | 5,569.8 | 42.0 | 67.4 | 29.5 |
| 1968 | 173 | 12,554.2 | 84 | 8,256.3 | 48.6 | 65.8 | 44.9 |
| 1969 | 136 | 10,966.2 | 49 | 5,761.3 | 36.0 | 52.5 | 34.6 |
| 1970 | 90 | 5,876.0 | 31 | 2,691.1 | 34.4 | 45.8 | 19.1 |
| 1971 | 58 | 2,443.4 | 17 | 960.6 | 29.3 | 39.3 | 8.9 |
| 1972 | 58 | 1,860.3 | 20 | 793.1 | 34.5 | 42.6 | 7.0 |
| 1973 | 64 | 3,148.8 | 22 | 1,661.3 | 34.4 | 52.8 | 8.6 |
| 1974 [3] | 62 | 4,471.3 | 21 | 1,402.6 | 33.9 | 31.4 | 10.3 |
| Total | 1,563 | 77,633.6 | 650 | 43,636.8 | 41.6 | 56.2 | N.A. |

[1] Acquired firms with assets of $10 million or more.

[2] Ranked by 1973 total assets.

[3] Figures for 1974 are preliminary.

Note: Not included in above tabulation are companies for which date were not publicly available. There were 346 such companies with assets of $8,161.2 million for period 1948-1974, of which 123 companies with assets of $3,168.6 million were acquisitions by the 200 largest firms.

Sources: Bureau of Economics, FTC Statistical Report on Mergers and Acquisitions, (Washington, D.C., October 1975), pp. 120, 122. Economic Report of the President, February 1975, p. 296 and Bureau of Economics, Federal Trade Commission.

Between 1954 and 1964 the annual number of large acquisitions ranged from 37 to 73 and the value of assets of the acquired firms ranged from $1 billion to $2.5 billion. In 1968 the FTC recorded 173 large acquisitions with assets of $12.5 billion, and in 1969 there were 136 acquisitions of firms with assets of $10 million or more with a total asset value of $11 billion. In the three years 1967, 1968, and 1969 some 447 large firms were acquired with assets of $31.8 billion. In the seven years 1960 to 1966, by comparison, there were 426 large acquisitions with assets totaling $17 billion. Acquisitions by firms among the 200 largest accounted for two-thirds of the large acquisitions in 1967 and 1968, as measured by assets. In 1967 the assets of acquired firms amounted to 29.5 percent of new capital investment in the U.S. In 1968 it was 44.9 percent and in 1969 it was 34.6 percent. As Table 2 indicates, from 1954 to 1966 the percentage fell in the range 7.8 percent to 17.8 percent.

Conglomerate mergers played a very important role in the late 1960's merger boom, as indicated in Table 3. In 1948 such mergers (in terms of the value of assets of large acquired firms) accounted for 37.5 percent of the total. In 1968, the peak merger year, conglomerate mergers were 88 percent of all large firm acquisitions. In 1973 conglomerate acquisitions had declined to 65 percent of the total.

There was both public and private concern over the conglomerate merger boom. In a speech to the Georgia Bar Association on June 6, 1969, Attorney-General John Mitchell noted that "from 1948 to 1966, only five firms with assets over $250 million were acquired. In 1967 alone, six such firms disappeared via acquisitions; and in 1968, the number rose to 12."[6] The concern of the Attorney-General is evident, for he stated:

> The danger that this super-concentration poses to our economic, political, and social structure cannot be overestimated. Concentration of this magnitude is likely to eliminate existing and potential competition. It increases the possibility for reciprocity and other forms of unfair buyer-seller leverage. It creates nationwide marketing, managerial, and financial structures whose enormous physical and psychological resources pose substantial barriers to smaller firms wishing to participate in a competitive market.
>
> And, finally, super-concentration creates a "community of interest" which discourages competition among the large firms and establishes a tone in the market place for more and more mergers.[7]

He went on to indicate that from 1952 to 1959 horizontal and vertical mergers accounted for 48 percent of all mergers, 39 percent from 1960 to 1963, 22 percent from 1964 to 1967 and

TABLE 3

ACQUISITIONS OF FIRMS WITH ASSETS OF $10 MILLION OR MORE
IN THE UNITED STATES BY TYPE, 1948-1974

| Type of Large Merger | Percentage of Assets | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | 1948 | 1951-1954 | 1955-1958 | 1959-1962 | 1960-1963 | 1964-1973 | 1948-1973 | 1968 | 1971 | 1973 | 1974 |
| Horizontal | 38.8 | 39.6 | 34.4 | 19.3 | 16.9 | 12.9 | 15.9 | 4.0 | 23.2 | 18.8 | 30.7 |
| Vertical | 23.8 | 8.9 | 20.2 | 23.8 | 20.2 | 7.3 | 10.1 | 7.0 | 0.4 | 15.9 | 1.1 |
| Conglomerate: Product-Extension | 37.5 | 42.7 | 38.6 | 26.9 | 37.8 | 37.7 | 37.4 | 39.0 | 30.8 | 13.3 | 22.6 |
| Market-Extension | | 3.9 | 2.1 | 8.2 | 8.0 | 7.9 | 7.3 | 5.9 | 2.2 | 15.3 | 7.6 |
| Other Conglomerate | | 4.8 | 4.7 | 21.7 | 17.1 | 34.3 | 29.4 | 43.6 | 43.4 | 36.7 | 38.0 |
| Total | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0* | 100.0 | 100.0 | 100.0 |

Sources: Phillip I. Blumberg, The Megacorporation in American Society in American Society, Englewood Cliffs, Prentice-Hall, 1975, p. 74; Federal Trade Commission, Bureau of Economics, Statistical Report on Mergers and Acquisitions, (Washington, D.C., October 1975), p. 117; Staff of the Bureau of Economics, Federal Trade Commission, "The Celler-Kefauver Act: Sixteen Years of Enforcement," Economic Papers, 1966-1969, (Washington, D.C., 1970), p. 80.

Definitions:

1. Market Extension Mergers -- "Acquiring and acquired companies manufacture the same products, but sell them in different geographic markets."
2. Product Extension Mergers -- The two companies "are functionally related in production and/or distribution but sell products which do not compete directly with one another."
3. Other Conglomerate Mergers -- "Involves the consolidation of two essentially unrelated firms." (Federal Trade Commission, Bureau of Economics, Large Mergers in Manufacturing and Mining, 1948-1968, (Washington, D.C., 1969), pp. 4-5).

*Error in the original source.

only 9 percent in 1968.[8] Mr. Mitchell identified four "specific dangers" resulting from conglomerate mergers: reciprocity; elimination of potential competition; the "expansion of nationwide marketing structures, capital resources, and advertising budgets", providing advantages over smaller competitors; and a "community of interest" in that "large, diversified corporations may have little interest in competing with each other in concentrated markets".[9] The Attorney-General then went on to expand the "Merger Guidelines" of the Justice Department which had been published May 30, 1968.[10] He said the department would probably oppose (a) any merger among the top 200 manufacturing firms or firms of comparable size in other industries, (b) any merger by one of the top 200 with any leading firm in any concentrated industry, and (c) mergers that may substantially lessen competition or develop a substantial potential for reciprocity.[11]

The FTC, in its Staff Report on corporate mergers published in 1969, also spoke to the problem of "super-concentration" and the role of mergers in increasing the share of assets accounted for by the 200 largest manufacturing enterprises. In 1947 the top 200 accounted for 42.4 percent of all manufacturing assets, in 1960 the proportion was 54.1 percent and in 1968 it was 60.9 percent. If it had not been for mergers the proportion in 1960, the FTC estimated, would have been 48.5 percent and in 1968 it would have been 45.3 percent.[12]

Just a year before the Attorney-General's speech, the Department of Justice issued its "Merger Guidelines" setting out specific market shares for both the acquiring and acquired firm which would result in the Department contesting the merger. Two categories of conglomerate mergers were also made subject to relatively specific structural guidelines; those involving potential entrants and those creating the danger of reciprocal dealing.[13] Less specific guidelines with respect to conglomerate mergers might have the effect of entrenching or increasing the market power of a leading firm in a concentrated industry.[14] The mandate of the White House Task Force on Antitrust Policy, originally commissioned by President Johnson, reflected the concern over conglomerate mergers. The Report released May 21, 1969 stated:

> The current rate and pattern of mergers is causing significant and apparently permanent changes in the structure of the economy, and the long run impact of these changes cannot be easily foreseen.[15]

The report identified three possible types of anticompetitive effects of conglomerate mergers: the elimination of potential competition; the creation of opportunities for reciprocal dealing; and the insulation of dominant firms in particular markets.[16]

It is recommended "additional legislation prohibiting mergers in which a very large firm acquires one of the leading firms in a concentrated industry" to supplement Section 7 of the Clayton Act. "The primary impact of the new legislation would be on diversification or 'conglomerate' mergers."[17]

Section 7 of the Clayton Act prohibits mergers "where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or tend to create a monopoly".[18] Since a pure conglomerate merger does not increase the level of concentration in individual markets,[19] they had to be attacked for lessening competition in other ways[20] and reciprocity was revived as an object of antitrust action. Loughlin argued in a 1970 article, that "reciprocity as it exists today represents, in part, past failures of antitrust enforcement".[21] He went on to say,

> It is regrettable that the enforcers' interest in reciprocity had to be awakened by the use of this issue as a tool to combat mergers, for reciprocity can also result from internal expansion into a new field.[22]

Regrettable or not, the U.S. antitrust authorities were being urged to take action against the wave of conglomerate mergers. Willard F. Mueller, Director of the Bureau of Economics of the Federal Trade Commission and principal author of the Economic Report on Corporate Mergers, in his testimony before the Senate Sub-committee on Antitrust and Monopoly in 1969, said:

> As I balance the costs of inaction, a policy of wait and see, against the costs of action that subsequent scientific inquiry may prove to be a too zealous policy, I choose the latter course without hesitation or reservation. For in the present circumstance, should a bold course of action prove later to have prevented some increases in economic efficiency, the matter can be righted by changing policy.[23]

Earlier, Mueller described the situation as a public policy "crisis" and said that "the enormous merger [was] threatening to engulf the [United States]".[24] Although opposing voices were heard,[25] conglomerate mergers were attacked with the weapons available or with whatever weapons could be fashioned by the practical men moving the antitrust policy levers. In a sense, there was a "failure" of conventional economic theory to incorporate the conglomerate firm in the structure-conduct-performance paradigm of industrial organization.[26] Neoclassical micro theory, particularly the Chicago school, chained to the precepts of profit maximization and competitive markets, did not view the conglomerate as a threat, but as yet another manifestation of the socially desirable operation of market forces. Robert Bork illustrates this point of view:

> The preferences of firms contemplating conglomerate acquisitions can only be explained on grounds of differential efficiency. By frustrating this preference the [proposed] Merger Act, like the [proposed] Concentrated Industries Act, operates on the principle that industrial fragmentation is to be preferred for its own sake to industrial efficiency. If we agree that antitrust is about consumer welfare, I cannot accept such a principle; indeed, I cannot even understand it.[27]

The officials responsible for antitrust enforcement felt they could not afford to wait until the empirical evidence was in regarding the impact on competition of the conglomerate firms. If they stayed their hand and the evidence did confirm their fears, it would be impossible to "unscramble the eggs". Divestiture in merger cases, particularly long after the mergers had been consummated, was an infrequently obtained remedy if one looks at the historical record. Besides, the decisions in antitrust cases are made by judges and the critics are primarily economists--it is not uncommon for a well-defined antitrust doctrine to have a questionable justification in economic theory.[28]

The problem was perceived to be one of preventing conglomerate mergers. The policy makers defended their use of reciprocity, which one described as the "hobgoblin of the antitrust critics", to attack conglomerate mergers. Assistant Attorney-General (Antitrust Division) Richard McLaren said the critics view that "anti-competitive reciprocity does not exist since, on the basis of economic reasoning, it should not exist, ...describes as a mirage, a practice which the major purchasing agents in this country only a few years ago acknowledged was the bread and butter of their existence, a practice which the Supreme Court has identified as a competitive danger...a very real fact of business life, and not a fragment of prosecutorial imagination".[29] He suggested the theorists go back and think again--"that is what we tell physical scientists when one of their theories does not seem to describe the real world with any great degree of accuracy".[30] The crux of McLaren's argument that reciprocity results in anti-competitive effects concerns the undesirability of permitting firms to transfer their economic power from one market to another. As he puts it, "it seems strange to urge that, because competitive forces are hampered in one market, the solution is to infect another".[31] Roland W. Donnem, Director of Policy Planning of the Antitrust Division emphasized the fair competition facet of the argument when he stated:

> The vice of reciprocity and reciprocity effect is that disadvantaged competitors--often small companies and single line companies--are deprived of sales they would otherwise be able to make on the basis of price, quality, and service.[32]

Reciprocity or the potential for reciprocity was not confined to conglomerate firms. Organized, systematic reciprocity programs were found to exist in a wide range of large industrial firms. In Appendix B we list 34 consent decrees (obtained between 1969 and 1974) in which reciprocal dealing was the focus of the decree. More than four-fifths were not associated with conglomerate mergers. They were obtained in respect of Sections 1 and/or 2 of the Sherman Act. In contrast, all but one[33] of the litigated cases launched by the Antitrust Division or the FTC in the 1960's and 1970's stemmed from conglomerate merger cases. T. E. Kauper, who succeeded Richard McLaren as head of the Antitrust Division, in a speech in early 1973, described the Department of Justice's attempt to eliminate systematic reciprocity as "one of the key areas of the Nixon Administration's antitrust enforcement program".[34]

The stage is now set. It only remains to indicate how the ensuing discussion (to call it a drama would leave us open to a charge of misrepresentation) will unfold.

Chapter 2 is devoted to a more extensive description of the variety of conflicting views held by economists, lawyers, and businessmen, in regard to the competitive impact of reciprocal dealing. In Chapter 3 we confirm the truth of Judge Canella's observation that "'reciprocity' is not a word of fixed meaning".[35] After expanding on the general concept of reciprocal dealing we outline five major types of reciprocity and indicate how the two dozen or so different terms used by various commentators should be classified. The implications for competition of each type are discussed briefly. Chapter 4 provides a fairly comprehensive discussion of the "empirical evidence" indicating the extent of reciprocal dealing by U.S. business firms. Unfortunately much of the evidence we are able to cite is impressionistic, based on small samples which lack scientific rigor and is indirect in nature. The tenor of the evidence is that reciprocal dealing probably increased from the 1920's through to the early 1960's. By the 1950's the practice had become widespread. The economic and managerial aspects of reciprocity are explored in some detail in Chapter 5. Reciprocity is seen to have both a beneficial and an adverse effect on the competitive process depending on a variety of circumstances. Reciprocity can be used as a vehicle to use otherwise unexploited market power and to adversely affect competition in the context of imperfectly competitive industries which buy from and sell to each other. In a considerable number of market situations we show that reciprocity will not be used, or if it is used it will have no economically significant effect or it will have a desirable effect on competition.

Chapter 6 examines all of the litigated cases in the United States in which reciprocal dealing was a substantive issues from 1963[36] through 1975. In each case we have tried to describe the

facts, the legal context of the decision and the key elements in the judgment. In addition, we relate one case to another as the law on reciprocity develops, and provide a critique of the legal and particularly the economic analysis of each decision.

We conclude with Chapter 7. Here we provide some modest proposals for Canadian competition policy in regard to reciprocal buying arrangements. Of necessity, they must be based on our review of the problem/issue in the United States. Reciprocity is not a competition policy issue in Canada at this time. There is no demand for legislation to prohibit or limit its use.

# CHAPTER 2

# THE SIGNIFICANCE OF RECIPROCAL DEALING: SURVEY OF THE CONFLICTING VIEWS

This section of the paper seeks to provide a survey of views in response to the question, "Does the practice of reciprocal buying/selling by large corporations constitute a significant problem of market power?" A useful analysis of public policy towards industrial organizations requires that such a question be examined through a variety of conceptual lenses and from a number of points of view.

Reciprocity, for the purposes of this chapter, can be thought of as an agreement, tacit or contractual, between two firms to buy from or sell to one another either conditionally (i.e., I will buy your output only if you agree to buy from me) or unconditionally. It is a business practice about which almost nothing has been written in Canada and on which a voluminous trade, legal, and economics literature has been produced in the United States, as the Bibliography attests.

## DIFFERING VIEWS OF RECIPROCITY

American opinion (we could find one item published in Canada) on the effects of reciprocal buying/selling is varied and conflicting. We shall illustrate this point by providing differing views of the problem as seen by economists, lawyers, and contributors to the business literature. While this survey is obviously not exhaustive, it does reflect the major themes in the debate.

### As Seen By Economists

The *Report of the Task Force on Productivity and Competition* states:

"The economic threat to competition from reciprocity (reciprocal buying arrangements) is either small or nonexistent: monopoly power in one commodity is not effectively exploited by manipulating the price of an unrelated commodity. The argument... that one cannot use the same monopoly power twice also challenges the fears of reciprocity." [1]

This view is echoed by James M. Ferguson who reasons that "a firm with market power in a factor market would be more likely to use it directly to obtain lower input prices than to exert it indirectly via reciprocity." [2] He goes even further, stating that "coercive reciprocity in which the buyer coerces his suppliers to buy from him at prices higher than those quoted by other firms has no foundation in economic theory." [3]

Ferguson completely dismisses as "being irrelevant or at least beyond the scope of a realistic antitrust policy," tacit reciprocity which "does not even involve mutual purchases but only purchases by one firm on the basis of hopes that the other will reciprocate."[4] Writing in 1965, after the Ingersoll-Rand case, but before Allis-Chalmers v. White Consolidated Industries and U.S. versus White Consolidated Industries and White Motor which upheld the concept of "reciprocity effect",[5] Ferguson would probably not be able to understand how such a legal edifice was erected on such a flimsy economic foundation. The Department of Justice defines reciprocity effect to be "the tendency of a firm desiring to sell to another company to channel its purchases to that company."[6] Ferguson develops three cases (many firms in both industries, one or a few buyers and many sellers, and one or a few buyers and one or a few sellers) in some detail.[7] His conclusion is stated as follows:

> The inevitable conclusion is that reciprocity is not a phenomenon that depends on market power, and the removal of market concentration would not eliminate the factors that give rise to reciprocity. At best, reciprocity can secure sales for the firm at equal prices. Competitors are foreclosed from sales at equal prices, but this will not affect competition as all firms can practice reciprocity. Given legitimate business reasons for doing so, there will be many such arrangements among firms that are mutual suppliers. Any successful selling technique will increase a firm's sales at the expense of rivals (assuming no corresponding increase in demand), but this is the very essence of competitive rivalry. These agreements will not lessen competition and, therefore, are not a proper concern of antitrust.[8]

Joel Dean, while noting that under certain circumstances reciprocity can be economically undesirable, says that "in most cases reciprocal trading is merely one of the many forms that competition takes in oligopolistic industries." It is a symptom rather than the source of market power.[9] Writing in 1963 he concludes that:

> The amount of reciprocal trading has probably been increasing in recent years. Far from a sinister plot against the competitive system, however, the growth in reciprocal trading is a predictable response to the changing economic environment of competition....[10]

Werner Sichel reviewed a number of the major papers on reciprocity in his 1968 article. He noted that a wide variety of restraints of trade are practised every day (advertising,

product differentiation, internal vertical integration, price leadership), but relatively few are attacked by antitrust. What are the criteria for the implicit exemptions? Sichel argues as follows:

> The two most important ones appear to be the degree of coercion and the degree of exclusivity. If the action is voluntary (no party involved is coerced) and if competitors or potential competitors have the opportunity to do likewise, it is implicitly exempted.[11]

He too is of the view that reciprocal dealing in the context of an oligopoly is a form of non-price competition. On this basis he concludes his paper by saying that its purpose was "to suggest that reciprocity dealings should be envisaged as non-price competition tactics which more often than not might be left unchallenged by the antitrust enforcement agencies."[12]

What is interesting about Sichel's analysis is that his criteria for antitrust illegality (coercion and exclusivity) are precisely the factors attributed to reciprocal dealing by its most severe critics. For example, the Staff Report of the Federal Trade Commission, Economic Report on Corporate Mergers, argues that "reciprocity introduces into the competitive process a distracting and potentially destructive factor" and that "reciprocity bypasses and distorts the competitive process."[13] The Report sees reciprocity as having a series of anti-competitive effects: (a) It changes "the mechanics of the competitive process by dampening rivalry based on price, quality, and service."[14] (b) It raises the barriers to entry--"in the extreme case, potential entrants would find much of the market 'tied up' by existing firms." A new entrant "might itself have to resort to conglomeration."[15] (c) "Reciprocity may further increase market concentration because it enables the advantaged firms to manipulate the demand for their products."[16] (d) "Reciprocity leads to structural changes that are irreversible and feed upon themselves...conglomerate growth becomes a source and a consequence of power."[17] The Report has an almost apocalyptic view of reciprocity.

> When large conglomerate enterprises engage in systematic reciprocity, industrial bigness and conglomeration rather than real economies threaten to become the key to business success. This is wholly alien to tenets of a free market economy. The ultimate result is an inflexible economic system composed of an industrial elite knit together by the exchange of reciprocal favors.[18]

As Seen By Lawyers

While not holding as strong a view as the FTC Staff Report, Donald F. Turner is persuaded that, on balance, there is little to be said for reciprocity. "At the outset, it may be stated flatly that reciprocity, even more than the tying arrangements it so closely resembles, has little or nothing to be said in its favor. Competition works satisfactorily only when success rests on lower prices, better quality, better service, and the like. Reciprocity distorts the pattern of trade away from the ideal, with no compensating economic advantages."[19]

Lawyer Richard A. Solomon takes what must be described as a simplistic view of reciprocity and proposes that it be attacked by the antitrust authorities. He states:

> Where the potential to use [reciprocity] is present, we may assume that without some form of prevention it will be used. The only question of consequence about reciprocity is how to stop it.[20]

Robert M. Hausman provides a longer analysis of the problem in a 1964 article in the Harvard Law Review, but he too condemns reciprocal dealing. Whenever it exists, he argues, "there is a departure from the process of open competition from which derive many of the benefits of a free enterprise system."[21] He indicates, "producers may buy supplies either to avoid losing sales in another market or to maximize their 'purchase credits'. The components purchased may be higher in price or inferior in quality if price and quality were the only relevant considerations."[22] Even when reciprocal dealing is practised on a basis of all other things (price, quality, service) being equal, Hausman says it will "injure the interests of competing sellers in the maintenance of a market in which the traditional rules of fair play, namely choice based on quality and price competition, are observed."[23] Firms which expand are "no longer the most efficient, but rather those which can employ reciprocal leverage most successfully." In addition, "entry by firms not established elsewhere is discouraged..." and the lack of the threat of entry "may significantly alter the conduct of sellers in a concentrated market in a way prejudicial to the consumer."[24] Since successful practitioners of reciprocity, Hausman argues, are likely to be the already large and diversified, "the industrial structure becomes more concentrated and the number of competitors fewer."[25] The need/desire to engage in reciprocal dealing may also result in acquisition or expansion by firms into markets to exploit opportuniities for reciprocity, hence increasing industrial concentration. Although it was published five years before the Staff Report of the Federal Trade Commission, it is obvious that Hausman's analysis of the economic significance of reciprocal dealing is very similar to that propounded in that volume.

Hausman concludes that in the light of what he sees to be the economic disadvantages of reciprocity "some form of legal condemnation would seem appropriate."[26] He proposes that the following be made unlawful per se:

(a) Simple reciprocal dealing agreements, i.e., those other than genuine barter arrangements of the sharing of business advantages,
(b) Forcing a reciprocal bargain or relationship on another, and
(c) Systematically using purchases or purchasing powers to promote the sales.[27]

In the only Supreme Court case involving reciprocity the practice was roundly condemned by Mr. Justice Douglas, who delivered the opinion of the Court. At the outset of his opinion he held that, "the reciprocity made possible by such an acquisition is one of the congeries of anticompetitive practices at which the antitrust laws are aimed. The practice results in 'an irrelevant and alien factor' intruding into the choice among competing products, creating at the least 'a priority on the business at equal prices.'"[28] He held also that "a threatened withdrawal of orders if products of an affiliate cease being bought, as well as a conditioning of future purchases on the receipt of orders for products of that affiliate is an anticompetitive practice."[29]

The opposite view is expressed by Richard A. Posner, Professor of Law at the University of Chicago, who dismisses the problem of reciprocity in one paragraph in his book Economic Analysis of Law. He argues that the practice of reciprocal buying cannot increase market power. He sees it "primarily [as] a device for granting price concessions indirectly: I pay you your regular price but you agree to buy something from me at higher than my regular price, in effect granting me a discount on your sale to me."[30] Like Stigler (the Chairman of the Task Force on Productivity and Competition cited above), he would see such behavior as pro-competitive as it is most likely to occur when there are legal or oligopolistic constraints on overt price cutting.[31] In an earlier article, Posner makes the argument that a monopolist or a monopsonist (a firm with market power as a buyer) cannot extend his power by the practice of reciprocal buying. He then proceeds to set up and demolish his opponent's views, stating:

> The typical replies to this argument are:
>
> (1) it assumes business men are rational and they are not; (2) reciprocal buying is in fact common; (3) even if reciprocal buying does not lead to higher prices, it excludes competitors from the market. The first objection, if true destroys the economic

foundation of the antitrust laws: the theory of monopoly. The second is irrelevant because the question is not whether reciprocal buying occurs, but whether it contributes to monopoly power. The third objection is irrelevant to the economic goal of antimonopoly policy, which is to assure competitive prices, not particular numbers of competitors.[32]

J. P. Anderson reiterates the argument that reciprocity cannot be used to create any additional market power, but that it can be used to transfer unexploited monopsony power to other markets. In doing so, Anderson argues, "reciprocity usually performs the function of an indirect price cut."[33] He states that situations in which such unexploited monopsony power can be used to increase profits "have one thing in common: they all involve some obstacle to complete freedom in pricing".[34] He continues, "this barrier may result from governmental regulation, a private cartel or simply the anticipated reaction of participants in the market (price leadership). These uses of reciprocity," he argues, "can serve both parties to a transaction, whether they be large buyers, small buyers, large sellers, or small sellers."[35] Hence, reciprocal dealing can have the desirable results of evading minimum price restrictions, making cost justified price cuts and avoiding non cost-justified price discrimination.[36] Anderson concludes that these uses "suggest that a rule of per se legality not illegality, should govern the practice of reciprocal dealing."[37]

In addition to asserting the reciprocity is a means of avoiding restrictions on pricing, L. W. Keeshan asserts that it "may be just an alternative method of generating goodwill, that reciprocal dealing may reduce selling costs, and that it may also reduce financial uncertainty for the firms engaged in it."[38] Keeshan finds favor with the practice when a firm pays a higher-than-market price for another firm's product. He asserts that "coercive reciprocity is not being used (which he earlier defined to be "forcing suppliers to pay costs that they would ordinarily not incur"[39]), but for one reasons or another a secret price concession is being made."[40] He concludes that reciprocity performs a variety of functions in different contexts, "none of which poses any serious danger to competition."[41]

<u>As Seen By Business Managers</u>

Not surprisingly, businessmen express a variety of opinions about reciprocal dealing. Some condemn it on ethical grounds and also for the reason that it results in managerial inefficiency. Others indicate they practice reciprocity reluctantly and do so because of competitive pressures. Businessmen who support the practice appear to do so for two types of reasons: the ties of friendship and because the policy provides a net advantage to the

firm. We shall illustrate the views of businessmen by quoting them directly.

We begin with the idea of reciprocity as business friendship. The President of General Tire and Rubber Co. has been quoted as saying, "Sure we would lean over to do business with a guy who does business with us. We call it a human equation. There is nothing wrong with that."[42]

A purchaser for a Cincinnati machine tool firm puts it this way: "What too many people label 'reciprocity' is really just good business practice. We market our product through distributors located in our geographic area. It's good business to also buy from these distributors."[43]

Another executive made the point this way: "We don't have a company policy on reciprocity. We just have some old friends that we've done business with for years. We wouldn't think of not buying from them if at all possible and vice versa. We like them and they like us. This is good, solid, friendly business--about 25 percent of our volume."[44]

Lionel Kestenbaum, of the Antitrust Division of the U.S. Department of Justice, states that such attitudes amount to what Thurman Arnold called "the personification of the corporation."[45] In such "antropomorphic imagery" the emphasis is upon the corporation's "little foibles and eccentricities--he likes to do business with his friends, a human frailty which is almost endearing to discover in the crass world of business."[46] Kestenbaum argues that the "realities" of reciprocal dealing are often vastly different. In particular he attacks systematic reciprocity which is "not at all like an individual's doing business with friends."[47] As he sees it, "reciprocity arises in large, diversified business organizations when management seeks to maximize the leverage of certain economic relationships. It requires the gathering and compilation of corporate data which is not normally available, and which does not serve other business purposes. And it demands the suppression of natural inclinations of those who are actually responsible for purchasing."[48]

Many executives whose firms engage in reciprocity emphasizes the *ceteris paribus* element in reciprocal dealing. A trade relations executive put it this way, "If you have two potential suppliers and all things look relatively equal as to price, quality, and so forth, you would be a damn fool not to give the business to your customer. It's plain common sense."[49]

The purchasing manager for a Kentucky equipment manufacturer said, "We feel it's good business to buy from our customers. But we won't pay a premium to do so. Whenever established customers can offer materials and services we can use, their

quotes will be considered first. But quality, service, and price must be equal."[50] And the secretary of a chemical company points out: "While reciprocity is not a company policy, we do feel that a certain amount is justified. It is only natural to favor a good customer where price, quality, and service are equal. We do not feel that reciprocity is desirable where carried to extremes and threats are made to secure business."[51]

Dauner quotes another executive as saying, "As long as reciprocity does not interfere with good purchasing practice, I see nothing wrong with the idea. Everything being equal I think it is a good policy to buy from your customers."[52]

In rebuttal to the ceteris paribus argument, Lee Adler, a vice president of McCann-Erickson Ltd., has stated, "This is specious reasoning. If all things are equal except that one company buys from the other, then all things aren't equal anymore."[53]

Executives who support reciprocal dealing with the ceteris paribus argument still seem at least slightly defensive about the practice. Other executives are much more aggressive in their approach:

> Our company recognizes reciprocity as a deliberate sales tool. Our policy is to practise it whenever it seems advantageous and legal to do so. Our company is large and diversified. We sell thousands of products. It would be foolish to ignore our tremendous buying power.[54]
>
> We have practised reciprocity whenever it seemed advantageous to do so, and we expect to continue to do so in the future.[55]
>
> Reciprocity is still considered ethical in our industry and used extensively. From the legal standpoint, if laws are passed outlawing reciprocity, there is a good chance that the practice will continue but under a different name.[56]

One of the most outstanding examples of systematic reciprocity, even if it was not extremely successful, was that which resulted from General Dynamics' acquisition of Liquid Carbonic. Evidence of the executives' enthusiasm for an active policy of reciprocal dealing can be found in the following quotations:[57]

> ...The single most powerful tool we have for increasing our business is to sell our products to the companies that enjoy business from other divisions of General Dynamics. (1959)
>
> As I see it, our Special Sales Program offers our company and every salesman in it a really powerful

> advantage which, used properly, patiently, and effectively, could easily generate five million dollars in new business over the next two years. (1961 or 1962)

> [Seeking] business via 'Trade Relations' is basically just another means of working to overcome competition.

> [Reciprocity is the] dynamite (that) can blow competition out of the picture.

Finney, on the basis of his interviews with sales and purchasing executives, found that reciprocal dealing was often <u>defensive</u> in nature.[58] One can cite other evidence to support this finding. For example, Lewis quotes a vice president of "one of the largest companies in the country" as saying,

> Frankly, we have been forced to use reciprocity due to the pressure that has been placed upon reciprocal purchases by some of our competitors.[59]

The Conference Board's survey, published in 1954, quotes a steel company executive as follows:

> Basically we do not feel reciprocity is a desirable practice, but in a situation where it is widely practised, it is necessary that we engage in it to some extent. Obviously, the pressures are greatest from the largest customers, many of whom are also suppliers to us.[60]

An article in <u>Sales Management</u> in 1960 echoes the same theme:

> We don't like reciprocity, but we have to use it. Our competitors do it and thus we're sort of forced to try to sell to our suppliers: if we don't our competition will. On the other hand, our customers expect us to buy from them because our competition does. We are just caught up in it.[61]

Business executives who oppose reciprocal dealing do so because they see the practice as resulting in inefficiency or see it as a practice that is ineffective. They also state their opposition in ethical terms or in terms of reciprocity's impact on the larger competitive process. All of these reasons are contained in the following quotations:

> Reciprocity, any way you look at it, is unethical. Legally, in my industry, you could be charged with restraint of trade if reciprocal agreements existed.[62]

> It limits competition, restrains fair trade, and encourages under-the-counter dealings.[63]

> We've never used reciprocity and never will. It's nothing more than a crutch. In the long run it works against the seller. It kills the initiative of the salesmen and reduces them to mere order takers.[64]

> We are not a particularly small company, neither are we the largest, but we have never used reciprocity in our selling and do not intend to do so. Buying on the basis of reciprocity only denotes poor management and poor selling, and in the end will reflect in a tremendous public reaction against the larger units of industry who are trying to stifle smaller units by this unfair method of selling. (Electrical machinery)[65]

> This company has always favored free competition, and has never felt that any sales advantages to be gained by reciprocity would offset the advantages of purchasing in a free market.[66]

> Reciprocity is undesirable for many reasons, but perhaps the most important is the fact that it tends to eliminate the normal relations between buyer and seller, and, therefore, tends to throttle the free competitive market. (Chemical producer)[67]

> Buying should be done objectively. It should not be influenced by pressures to throw business to good customers. By permitting certain people special privileges as suppliers, we would discriminate against other worthy suppliers. The favorite supplier is likely to consider himself entrenched and become careless in service and price. Past experience with reciprocity showed us that normal buying patterns were distorted and business became a matter of maneuver rather than competition. (Machinery manufacturer)[68]

After reviewing the conditions which facilitate reciprocal dealing, some of the side effects of reciprocity, the concept of 'trade relations potential', and the apparent ethical stigma associated with the practice, Dean Ammer writing in the Harvard Business Review concludes, "I believe that reciprocity is inherently unprofitable and is least profitable for the companies that are its most enthusiastic proponents. I believe that reciprocity raises most companies' purchasing costs."[69] He provides a well reasoned argument why this is so. In addition, he argues that reciprocity weakens a firm's sales effort.[70]

In 1967 Norton Simon resigned from the board of Wheeling Steel. When he took over the firm three years earlier the practice of reciprocity where sales/purchasing practices were "significantly based on vendor-directors working with management directors for the best interests of each...was leading the company to absolute and inevitable destruction."[71] In September 1966 Wheeling brought suit against three ore suppliers, alleging a price-fixing conspiracy. For more than 20 years, Wheeling alleged, it was "coerced into unfavorable contracts for ore procurement."[72]

Inertia is apparently a powerful force in maintaining reciprocal dealing arrangements. The president of General Foods, whose firm had abandoned its trade relations department some years earlier is quoted as saying, "While many suppliers know it is legally and ethically wrong, they continue to put up with it simply because it has become a policy that they don't dare abandon. What's more, they will accept products of inferior quality or higher price, and downgraded service, for fear of upsetting the arrangement."[73]

## RECONCILING THE CONFLICTING VIEWS

The reader may be excused if he avows that he is quite confused after reading our summary of the variety of views as to the desirability or undesirability of reciprocal dealing among business firms. As we have shown, one can marshall an assortment of economists, lawyers, and businessmen who condemn the practice as both privately inefficient and socially anti-competitive. One can also assemble a body of similarly distinguished opinion that, at worst reciprocity is innocuous (both privately and socially), and at best it is a desirable form of non-price competition which can erode oligopolistic or regulated price structures. Neither side is totally correct nor totally wrong. In fact, a good many of the arguments put forward on both sides are correct under certain circumstances. The problem is that the arguments and hence the conclusions as they are frequently stated suffer from what has been referred to as "lump concept thinking"[74] and from a desire for generality of statement even when the problem would appear to cry out for a variety of contextually determined statements and conclusions. In addition, the conflict in positions as to the appropriate public policy toward reciprocity is at least partially based on the failure to specify the set of objectives or criteria by which the implications of reciprocal dealing are to be judged. For example, analysts usually fail to distinguish between the private and social efficiency of reciprocity and between the static and dynamic implications of it.

With respect to the issue of lump concept thinking we are reminded of the following analogy. The graduate student of public finance is asked, "What is the incidence of the corporation income tax?" If he is wise he will begin his answer with the words,

"It depends, there are several cases...". As to the significance of reciprocal dealing for public policy one must say, "There are many cases." Only after one has specified at least a half-dozen facts about a given reciprocity situation (primarily those dealing with the structural elements of the markets involved) can one begin to say anything useful about the problem.

The only serious attempt to do this was by Steiner, but his admirable discussion is incomplete.[75] He identifies seven types of reciprocity, discusses the variety of motives for practicing merger-induced reciprocity and examines the important judicial decisions. From his analysis Steiner predicts the economic effects of reciprocal dealing for 12 cases, i.e., various combinations of the market structure in which the acquiring firm operates and the market structure in which the acquired firm operates.[76] We will consider a larger number of cases, and determine which of the potentially very large number of combinations of market and firm circumstances are either of little or of any public policy significance. To show how the number of possible cases can quickly grow unmanageable, consider the following plausible example. Suppose we have a firm operating in two industries, each characterized by six elements of market structure and four factors of intra-firm organization pertinent to reciprocity. The number of possible cases is 6 x 6 x 4 or 144. Even if two-thirds of these cannot be made usefully distinguishable for policy purposes we are still talking of four dozen different combinations of circumstances with which the public policy maker may have to deal.

## THE PAUCITY OF EMPIRICAL RESEARCH

The problem is not made easier by resort to empirical research which might be able to tell us which of the theoretically significant cases are significant in fact. Jones and Heiden state:

> No systematic studies have been conducted, for instance, relating the frequency of actual reciprocity behaviour to the structural conditions of the market which some economists believe foster it. What evidence there is on actual reciprocal behaviour consists largely of individual case studies. Likewise, there has been little or no evidence on the question of precisely what the anti-competitive effect of reciprocity has been even in those cases where it was found to actually exist, i.e., to what extent the affected markets were foreclosed through the reciprocal dealings, and whether concentration and entry barriers were increased and/or prices rigidified and stabilized.[77]

Since their assessment in 1970, only one paper has attempted to do what they suggest is necessary. Bruce T. Allen used a

logit model, multiple regression analysis to assess the extent to which selected structural characteristics "predict" whether firms use reciprocity.[78] The independent variables were: the average degree of concentration in the firm's markets, the volume of a firm's purchases from other firms and a measure of the firm's product diversification.[79] The data were from the early and mid-1960's, when "the legal deterrant was still ineffectual."[80] A sample of 50 large firms was just about evenly divided between those who either "definitely" practiced reciprocity (n=22) or "probably practiced" reciprocity (n=4) and those who did not (n=24).[81]

The results indicated that only the market share and diversification variables were statistically significant. The former was negative in sign while the latter was positive.

On a priori grounds the sign of the market share variable could be either positive or negative, while theory posits that the sign for the diversification variable should be positive. Allen concludes that since reciprocity is negatively related to market share, "evidently it is practised by companies with smaller market shares, as a device for cutting prices and hiding the evidence from large rivals."[82] With respect to diversification, "The more five-digit products a company makes, the more opportunities for reciprocity it has and uses."[83] Allen notes this result is opposite to Markham's conclusion (which we will discuss in Chapter 4), but this may be explained in that "the level of Markham's aggregation hides the really significant opportunities for reciprocity."[84]

Allen's results are important in that they constitute the first attempt at scientific empirical research. However, much more work remains to be done, since the number of variables employed in his study was quite limited, alternative definitions might be employed, and the size of the sample needs to be vastly enlarged. More importantly, cross-section regression analysis does not help us to predict the dynamics of reciprocal dealing. Jones and Heiden comment on this point and related matters.

> Identifying the conditions which transform the threat of reciprocity into actual practice requires an analysis of such issues as whether there is a critical market share which a firm must have in order to practice reciprocal leverage rather than simply pose the threat; how nearly equal the value of reciprocated products must be in relation to each other for reciprocity to be activated; how concentrated and conglomerated the industries are in which actual reciprocity has been observed; have conglomerates generally entered into the types of acquisitions which have given them the opportunity for this type of

behaviour; and under what market conditions have firms exercised reciprocity. Certainly, analyses of volume sales and purchases of conglomerates with other companies pre- and post-merger would help to resolve this latter question. Moreover, there is sufficient raw material available to allow some fairly informed estimates of the structural industry situations most conducive to potential reciprocal dealing.

To assess the anti-competitive effect of actual reciprocity, we must determine from industries where reciprocity is an observed practice whether it brings with it any changes toward a more anti-competitive market structure and worsened economic performance, e.g., whether prices have become more rigid or more flexible, whether concentration has increased, entry been retarded, exit hastened, defensive mergers promoted, and whether the theory is supported which predicts that observed anti-competitive effect is most signficiant in those cases where reciprocal foreclosure has been the greatest.[85]

What is needed is both a more careful theoretical analysis which reflects the numerous facets of the problem of reciprocal dealing and also more comprehensive empirical studies. The monograph is an attempt to make a contribution to the former need.

# CHAPTER 3

# RECIPROCAL DEALING: THE PROBLEM OF DEFINITION AND CLASSIFICATION

The legal, economic, and business literature on reciprocity is hampered by the use of a wide variety of terms to describe the different types of reciprocal dealing. When discussions of reciprocity became more frequent in the literature in the 1960's so did the authors' desire to distinguish the circumstances in which reciprocal dealing could and did take place. With few exceptions, each writer used his own terminology. Even when the same word or phrase was used it seldom had the identical meaning stated or implied by other writers. The terminological confusion contributed greatly to the variety of opinions as to the significance of the practice and the relevant public policy toward reciprocity. In this section of the paper we hope to reduce the definitional and semantic confusion by proposing our own framework (adapted from Steiner[1]), which incorporates many of the terms and concepts adopted by other authors. We begin with the general concept of reciprocal dealing and then identify five major types, a number of which have sub-cases.

## THE GENERAL CONCEPT OF RECIPROCAL DEALING

One of the most general definitions of business reciprocity (as opposed to the use of the term in international trade) is given by Ferguson. He defines it to be "the bilateral practice in which the buyer agrees to purchase from the seller and the seller agrees to purchase from the buyer at specified prices."[2] Sichel says the same thing in only slightly different words when he states:

> Business reciprocity, simply defined, is the established practice of firms in their role as buyers of inputs to favor at particular prices, those firms that buy their output.[3]

Stocking and Mueller offer the following definition:

> 'Business reciprocity' as we shall use the term describes business dealings between independent firms whereby they make mutual concessions designed to promote the business interest of each. The best known form of business reciprocity is reciprocal buying. Reciprocal buying involves the use of a firm of its buying power to promote sales.[4]

To Westing, Fine, and Zenz reciprocity "refers to the practice of buying from a company that buys from you because this company buys from you."[5] To these authors, mutual sales/purchasing

arrangements do not constitute reciprocity unless "each company's buying can be explained, at least in part, by the other company's buying."[6] They are not the only ones to emphasize the conditional nature of the selling/buying arrangement. Hausman puts it this way:

> Reciprocal dealing is both the use of purchasing power to obtain sales and the practice of preferring one's customers in purchasing.[7]

Commissioner Elman in the case of the Federal Trade Commission v. Consolidated Foods defined reciprocity as follows:

> As generally understood, reciprocity describes the practice whereby firms, overtly or tacitly, make concessions to one another in order to promote their own business interests. Perhaps the most common form of reciprocity is the type involved in this case --reciprocal buying. In this context it involves nothing more than the simple idea that "I will buy from you if you will buy from me", or the unspoken, "if I buy from him, he will buy from me."[8]

VARIOUS DEFINITIONS

As can be seen from even this brief review of the general concept, the various statements imply potentially different kinds of reciprocal dealing. We must now draw what we believe are useful distinctions, i.e., distinctions with a difference. For easy reference, the main characteristics of type of reciprocity discussed here are set out in Table 4 on page 30.

Coercive Reciprocity

The essence of coercive reciprocity is the use of threats or pressure to induce a firm's suppliers to buy its products in return. The threat or pressure, which may be overt or only implied (but still clearly communicated), involves the partial or total withdrawal of purchases if the initiating firm is not able to make the sales it desires.[9] The source of the power is the would-be seller's market power in the purchase of its inputs. It has a degree of monopoly power. Thus coercive reciprocity has been referred to as the "rise of a dominant position in a market or of substantial buying power in that market to require a supplier to buy from a designated source."[10]

This idea is described by Keeshan who states that coercive reciprocity is a situation where a firm that solicits its suppliers' business on pain of withdrawing its own purchases. "...A, which buys from firm B, uses it buying power to force B to buy from it or its affiliates. If A did not exercise this 'leverage'--for example, by threatening to withdraw its orders--

B would not have purchased from it, or would have purchased less of its product, or would have purchased at a lower price."[11]

Dunne also refers to coercive reciprocity as "leverage reciprocity" when he describes it as "the economic force that a purchaser of goods wields on its sellers, pressuring them to buy the purchasers' products." [12] In colloquial terms it is, "If I buy from you, you must buy from me, or I will not buy from you anymore." [13]

Barton goes so far as to state that where "a purchase [is] conditioned upon a sale...[it] may be considered inherently coercive." [14] Ferguson argues that "coercion to induce purchase is only necessary when the buyer-seller is selling a good at a higher price or lower quality than is available from other firms."[15]

Coercive reciprocity is most sharply criticized because, the critics assert, it results in the firm it is used against paying more than it otherwise would for its inputs (or forced to accept a lower standard of quality and/or service). As Keeshan puts it, the coercive element is in "forcing suppliers to pay costs they would ordinarily not incur."[16] As we shall point out, the fact that a firm pays more than the going price for certain of its inputs may also be seen as an <u>indirect price cut</u> on the sale of its outputs. Yet it is the higher cost of purchasing that is condemned as wasteful and inefficient.

It is useful to emphasize that the ability of a firm to coerce its suppliers to <u>buy</u> from it at market or above market prices, <u>ceteris paribus</u>, is based on the existence of <u>unexploited</u> market power in the coercing firm's input markets. Reciprocity cannot create market power, it is simply a way of using market power by redirecting it from the firm's input to its output market.[17] It is often argued that firms with monopsony power will use it directly to lower their input costs, but as we shall show in Chapter 5, there are good reasons why a firm is not able or willing to fully exploit its buying power directly. Instead it finds reciprocal dealing a convenient way of using its otherwise unutilized market power or for transferring such power from one market to another.

There is a special case of coercive reciprocity which, following Steiner, we will call <u>fraudulent</u> reciprocity. Here "purchasing agents or other employees of a Firm B with monopsony power use some of that power to acquire a payoff to <u>themselves</u> in the form of purchases by B's suppliers of a product which is produced by a Firm A in which these employees have a significant financial interest."[18] As Steiner points out, "This is clearly a form of bribe to the purchasing agent and comes at the expense of B's shareholders, among others."[19]

TABLE 4

CHARACTERISTICS OF FIVE TYPES OF RECIPROCAL DEALING

| Characteristic | Type of Reciprocity | | | | |
|---|---|---|---|---|---|
| | Coercive | Coincidental | Hortatory | Consensual | Reciprocity Effect |
| 1. Requires the existence of unexploited monopsony power | Yes | No | No | Not necessarily | Yes |
| 2. Organized or systematic program of reciprocal dealing by one or both firms | Almost certainly | No | No | Possible | Possibly, but unnecessary for dominpartner to communicate its program in this instance |
| 3. Conditional element--purchases conditioned upon sales | Yes | No | No | Not Conditional but efficiencies depend on joint dealing | Yes, in that minor partner fears loss of its sales unless its purchases from dominant partner |
| 4. Prices paid for inputs (quality and service cet. par.) above competitive level (those offered by nonreciprocators) | Possibly | No | No | Possibly, but net position must be better than in unilateral behavior | Possibly |
| 5. Formality of arrangement | Varies | No arrangement, occurs by chance | Informal | Varies | Almost certainly tacit, no formal agreement |
| 6. Use of overt threats/promises, pressure to engage in reciprocity | Yes | No | No attempt to back up urging for reciprocal dealing | None | No, but see 3 above |
| 7. Initiative for reciprocity | From firm with market power | Either side | Either side | Either side | From minor partner |
| 8. Stability of arrangement | Probably fairly stable | Episodic, not occur by design (not an arrangement) | Probably unstable, short term | Tends to be fairly stable (cet. par.) | Variable, depends on willingness of dominant partner to reciprocate or make implicit power credible |

The outstanding example of a type of reciprocal dealing was found in the Waugh Equipment case in 1931.[20] Three senior executives of Armour & Co. had obtained a significant interest in the Waugh Equipment Co., manufacturers of draft gears and other railway equipment. As each passenger or freight car had to have two draft gears which acted as a cushioning and shock-absorbing device Waugh's potential sales to railroads were very large indeed. The Armour executives, with their ability to allocate their firm's considerable traffic (Armour operated a fleet of 7,000 cars for its own use and its total business amounted to 275,000 carloads per year[21]) were able to induce the railroads to purchase their draft gears from Waugh Equipment. Despite the fact that Waugh was "manufacturing and selling a practically unknown gear"[22] in competition with at least eight other competitors, it was able to increase its share of the market from 1 percent in 1924 to approximately 35 percent in 1930. The FTC concluded that the executives involved and Waugh had "created and taken advantage of a competitive weapon, oppressive, and coercive in nature, which prevents the customers...from exercising their free will and judgment in determining which device is the most efficient and will best serve their needs at the lowest net cost over a period of time...."[23] It was deemed to be a violation of Section 5 of the Federal Trade Commission Act.

A parallel case, decided at about the same time, was Mechanical Manufacturing.[24] This firm, also a manufacturer of draft gears, bumping posts and centering devices, was owned primarily by members of the Swift family with a small amount of the common and preferred held by executives of Swift & Co., the large meat packing firm. Through their ability to award or switch Swift & Co.'s railroad shipments to different lines, the two key executives involved sought to promote the sales of Mechanical's draft gears. No precise evidence of the success of policy is given, but in 1929 it appears Mechanical had only about 5 percent of the total market.[25] In December of that year Mechanical sold its licence to manufacture centering devices to Waugh Equipment and recommended that its customers purchase draft gears from Waugh. The FTC reached the same conclusion, and used much the same language, as it had in the Waugh Equipment case.

## Coincidental Reciprocity

This form of reciprocity is at the other end of the spectrum from coercive reciprocity. Steiner says, "This relationship occurs when two firms purchase each other's products simply as a result of market choices."[26] Barton describes this "a coincidence of mutual purchase and sale."[27] Moyer points out that such reciprocal dealing may be inadvertant or even unrecognized by the parties. He states, "Often pairs of buyers-sellers may be unaware of the reciprocal arrangement existing between the two companies. Or two firms may buy from each other but do so on rational economic grounds, each refusing to let its selling arrangement influence its purchases."[28]

Backman is referring to coincidental reciprocity when he speaks of "the buying and selling which may develop without any formal determination, for example, as different divisions or subsidiaries happen to buy from and sell to the same independent non-affiliated company simply because each company is the most desirable source of supply for the other company. These relationships usually are fortuitous or unsystematic."[29]

What Finney refers to as "friendship reciprocity" could also be incorporated into this category. He states it "is the simple act of purchasing from the individual or firm that is also one's customers," for "it is natural to do business with your friends."[30] Finney points out that where this type of reciprocity is practiced, it "lies mainly within the province of the purchasing department."[31] Preference is given to the supplier who is also a customer only after it is determined that price, quality, and service are equal. Such friendship reciprocity has been recognized by the courts in the 1953 Investment Bankers case where Judge Medina said, "In the course of a business relationship it is a natural and normal thing for those in the same industry occasionally to seek business on the basis of business given."[32]

Several points should be noted about this type of reciprocity: (a) It tends to be casual and occur in an uncoordinated fashion. It is not accompanied by a systematic effort to coordinate the sales and purchasing activities of the firm--in particular the provision of information concerning the volume of purchases by supplier to the sales department.[33] (b) There is no conditional element in such arrangements. In fact, it is not an "arrangement" at all since the reciprocity is the result of independent sales and purchasing decisions. (c) This form of reciprocity can exist in the absence of the possession of market power by either firm. Ferguson makes this point when he says, "The fact that reciprocity is often practiced by firms without market power is strong evidence that there are legitimate reasons for the practice."[34] (d) With coincidental, convenience, or casual friendship reciprocity one would not observe a firm paying more than market price (or accepting lower than the competitive level of quality or service) for its inputs. For a comparison of the various types of reciprocity see Table 4, page 30.

## Hortatory Reciprocity

In this type of reciprocity we recognize that Firm A tries to use the fact that it is also a purchaser of Firm B's output in making sales to Firm B. In this context reciprocity is a marketing tool; it is used by individual salesmen "to get their foot in the door of potential customers"; but, Steiner continues, there is "no credible threat of retaliation if their plea is rejected."[35] Ferguson puts it this way, "Possibly these are only suggestions by one company that simple justice requires that the other should

buy from the first in view of the first company's purchases from it."[36] Harsha points out that where this type of overture is accepted such reciprocal dealing becomes "a mutual agreement whereby each company reciprocally agrees to buy from the other."[37] Steiner notes that examples of aggressive behaviour by salesmen is offered as support of the contention that coercive reciprocity is being attempted while the latter is defined as "mere examples of salesmen's zeal."[38]

Kaapcke describes the problem of when a company utilizes sales data to decide on where to place its purchases and how such data can be utilized in hortatory reciprocity.

> ...I think that marketing executives may consider the company's purchases and review purchasing figures for the limited purpose of identifying likely sales prospects among those who are suppliers to the company. But salesmen being the gung-ho types that they are, I would suggest one not give these figures to actual salesmen in the field; because the salesman, of course, will use any entree that he has or any arguments that he can contrive in order to try to gain his sales objective. Salesmen have to be like that or they wouldn't be successful.[39]

Gouldner argues that in social relationships the norm of reciprocity is as universal and as important as the incest taboo.[40] Even in the context of the supposedly impersonal market, a salesman's exhortation to reciprocate may be a useful selling tool. Where it cannot be backed up by changes in purchases, it still may be able to affect a sale when price, quality, and service factors are identical. The point is often put this way, "What's wrong with buying from a customer under such circumstances?" As one executive puts it, "What kind of guy would you be if you didn't?"[41]

Certain elements of what is referred to as "trade relations" would appear to come under the label hortatory reciprocity. While trade relations is often just a euphemism for organized or systematic reciprocity,[42] its defenders emphasize the intelligence and diplomatic functions of a trade relations department. In particular the emphasis is on obtaining access for salesmen through high level contacts so they can "tell their story". An article in Fortune states, "The T.R.'s first concern is to make certain that 'friendly' companies--by which he means companies that his organization buys from--include his firm as a possible supplier on their purchasing lists. With many multi-layered and multidivisional companies turning out a profusion of products, that is not always easy to ascertain."[43] Trade relations men, the article continues, "have served their most important purpose after they have won an equitable hearing for

their company."[44] Garrison and Hooker emphasize the diplomatic function, viewing the trade relations manager as "the ambassador of his corporation."[45] As such, he is a "mender of fences", but "it is also his responsibility to use his contacts and acquaintances to open the way for his company's sales force."[46] To the extent that these activities are performed without the express or implied use of the company's purchasing data to sell to suppliers, they may be included in this type of reciprocity.[47] However, when a company <u>systematically</u> collects data indicating its purchases by supplier, makes such data available to the trade relations and/or sales officials, it is too much to ask to believe it is not being used to at least remind sales prospects of the extent to the sellers purchases and in that way to apply pressure to engage in reciprocity.

Can we really distinguish hortatory reciprocity from a very subtle form of implicit coercive reciprocity? The main element is that in hortatory reciprocity there is no threat or action to back up the urging for reciprocal dealing. Second, it is usually casual, intermittant and unsystematic; relying more for its implementation on the individual salesman than on company policy. Third, unexploited market power may or may not exist. If it does exist there is no conscious corporate use of such power in the sense of making purchases conditional upon sales. Fourth, the prices paid for inputs will not be above the competitive level. Compared to coincidental reciprocity, there is a consciousness as to the existence of actual or potential reciprocal dealing, and although there may be market power there is no credible threat to utilize it. (See Table 4, page 30.)

<u>Consensual or Contractual Reciprocity</u>

This type of reciprocity occurs when both parties to the arrangement find it beneficial to engage in reciprocal dealing with each other. Steiner argues that, "sometimes this sort of reciprocity follows recognition by both parties that are real economies to be had in avoiding selling and purchasing expenses and in assuring stable supplies and sales, sometimes it is purely inertial."[48]

Vanderstar describes consensual reciprocity (although he doesn't use the the term) which he says, "occurs where neither company is significantly larger nor more powerful than the other or where neither is highly dependent upon the other's customer. However, the companies have grown accustomed to the mutual buyer-seller relationship and neither will work too hard to find an alternative source for the product it buys from the other."[49]

The arrangement may be formal, i.e., expressed in written contracts or it may simply take the form of an understanding that the two firms will sell to each other. Steiner suggests that "in some, but not all cases, a condition is imposed that

the supplier will meet the price and quality of any offered alternative source of supply."[50] We would argue that if such reciprocal dealing is truly motivated by the search for transactions economies, deviations from competitive price, quality, and service terms can only be of a episodic, short-term nature.

What John Narver refers to as "convenience reciprocity" comes under this type of reciprocal dealing. This occurs, Narver says, when, "I produce something I note that you use. You produce something that I can use. Why don't we simply trade with each other at the market price and that would save you some selling costs and it would save me some selling costs, save us some administrative costs, perhaps, no more, no less."[51] As a result, Narver concludes that this type of reciprocity is "basically benign" in its impact.[52]

What Keeshan describes as the courts' model of "mutual-patronage reciprocity" should also be included in this category. Firms voluntarily exchange sales on a regular basis. "This model does not base the relationship on the exercise of leverage by one party; rather, both parties freely engage in reciprocity in order to strengthen each other's position in their respective markets."[53] They strengthen their positions, it is argued, by "denying other producers access to their business and allowing each effectively to capture a portion of its market."[54] But, Keeshan points out, to do this firms would be working against their own interests in allowing their input markets to become concentrated. In fact they would want to encourage new-entrant suppliers. He concludes that where such reciprocity exists "it is probably performing functions other than preserving and strengthening each firm's market power."[55] Keeshan offers four "more plausible explanations of reciprocity": as a means of avoiding restructures on pricing, as an alternative method of generating goodwill, a technique to reduce selling costs, and a method to reduce financial uncertainty.[56] The last three seem most applicable to this type of reciprocal dealing.

Dunne refers to mutual patronage reciprocity as an "negotiated reciprocity agreement" which "is an express agreement to exchange products or services. It is expressed as I agree to buy from you, and you agree to buy from me."[57] Ferguson and Harsha refer to the same thing when they talk of "an agreement whereby each company agrees to buy from the other."[58] Kaapcke refers to "negotiated reciprocity" as "reciprocal dealing which, without any suggestions of coercion or force, is based upon the communicated purpose, the condition between two parties, that my purchases from you depend on your purchases from me." Writing in 1967, he indicated that this type of reciprocity "is where the real antitrust concern centers today."[59] Handler also describes one form of reciprocity as "free and voluntary mutual patronage."[60]

He describes such behaviour as "innocuous" and "inveterate" for he argues that while we observe two purchases and two sales, each is "the product of free and independent decision."[61] He points out that in his belief for the FTC in the Consolidated Foods case, the Solicitor-General "concedes that existing law does not touch such mutual patronage."[62] In fact, what the Solicitor-General said was, "Unilateral practices are by definition not covered; and whether a mutual course of reciprocal dealing without explicit agreement is consensual is, as in other areas, a hopeless conundrum."[63] We would conclude that what Handler is really talking about is what we have called coincidental reciprocity. Clearly, semantic confusion abounds.

In the General Dynamics case Judge Canella said "mutual patronage reciprocity "occurs when both parties stand on equal footing with reference to purchasing power inter se, yet agree to purchase from one another."[64] Later in his judgment he makes the point more strongly: "with mutual patronage reciprocity... purchasing power is used by both parties as a sales generating device, although no force is exerted from any quarter."[65] Judge Canella was careful to insist that there must be an agreement to deal reciprocally rather than reciprocity to come about as a result of one firm's unilateral action to purchase from a firm to whom it already sells.[66] He did this because Section 1 of the Sherman Act begins "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade...." (see Appendix A).

Can we really distinguish consensual or contractual reciprocity from the coercive or coincidental types? We offer the following points in support of the position that differences can be discerned: (a) While firms may possess unexploited monopoly power they do not seek to utilize it in making sales as is done in coercive reciprocity. Rather they seek efficiencies in purchasing and selling through mutual patronage. (b) Unlike coincidental reciprocity, in the consensual variety the parties knowingly seek out reciprocal arrangements that will be beneficial without resort to their "purchasing leverage". Such arrangements may involve written contracts, but they may also simply be understandings of continued mutual patronage so long as it remains beneficial for both parties. As one lawyer has remarked, "It is not likely that reciprocity dealings can easily be reduced to contract forms, written or oral."[67] (c) It is highly unlikely that consensual reciprocity will be associated with the carefully planned systematic efforts at reciprocity usually associated with coercive reciprocity. While purchases and sales may be conditional upon one another, they are so because only in that way can the joint economies be achieved. In the typical coercive case, as we have noted, the conditional nature of the transaction is emphasized and in it one side seems to more clearly benefit than the other.

(d) With mutual patronage or consensual reciprocity, nominal purchase prices may be above the apparent alternatives, but this will be a short-term phenomenon or other elements of the deal (e.g., stability of production or supply) will outweigh this disadvantage.

Reciprocity Effect

The types of reciprocal dealing coming under this category have at least a dozen different names. Apparently the term was first used by the Department of Justice "to describe those situations which do not technically involve reciprocal purchasing by parties, but where the purchasing power of the firm nevertheless causes others to purchase from it. [It] refers to the tendency of a firm desiring to sell to another company to channel its purchases to that company."[68] The concept was recognized in the first of the modern reciprocity cases, Consolidated Foods, although that term was not used.[69] This definition gives rise to the concept of "unilateral reciprocity", which appears to be a contradiction in terms. Dunne refers to it as unilateral or volunteer reciprocity. "It is the underlying scheme of purchases used to produce or increase sales. It is the implied idea of 'If I buy from you, I hope that you will buy from me'."[70] Ferguson and Harsha describe the practice as, "One company purchases from another, tacitly hoping that the other company will thereby reciprocate."[71] Because of the unilateral character of this activity, Ferguson dismisses such activity as "irrelevant" because it "does not even involve mutual purchases."[72] For this reason, it is useful to follow Steiner's distinction between "unrequited" reciprocity, where "the larger purchaser is unmoved by the fact that some suppliers or potential suppliers newly purchase from it", and "requited" reciprocity, where such advances are rewarded by a shifting of purchases. It doesn't seem too extreme to imagine a U.S. antitrust case involving unilateral reciprocity where the defendant argues that such reciprocity was "thrust upon" him by the actions of the other (initiating) firm. By inadvertantly making purchases (or increasing the purchases) from the initiating firm the defendant gives the appearance of requiting the advance and entering into a regular reciprocal relationship. Steiner argues that "this 'reciprocity effect', if requited, is identical in effect to consensual reciprocity, although the initiating party may be different."[73]

Backman is critical of the whole concept of reciprocity effect. He states:

> Such action is unilateral. There is neither pressure on, nor obligation by, the second firm to buy the products of the first. The unilateral unreciprocated purchasing policy of a firm will not long be continued by businessmen who act rationally, unless the purchases are economically attractive on their merits.

> Such unilateral purchases do not result in reciprocity and involve no market foreclosure. Thus it does not adversely affect competition...The theory of 'reciprocity effect' is exaggerated beyond all relationship to its possible economic importance.[74]

There are, however, some additional facets to reciprocity effect.

Weston speaks of "spontaneous" reciprocity. By this term, he refers to the "contention...that a large conglomerate buys in large volume from many firms, and sellers will spontaneously recognize that the buyer may shift his purchases if reciprocal transactions are not made."[75] What Krash describes as "psychological reciprocity" is very similar. It is the situation where a firm has so much purchasing power that its suppliers will act as if the firm has a reciprocity policy, even if there is no indication of one.[76] Harvith refines the concept as "negative psychological reciprocity", in which "the suppliers conduct is aimed, not at increasing the big firms purchases from them, but at inducing the big firm not to reduce those purchases...[or it is] aimed at inducing the big firm to continue to purchase the present percentage of its total requirements of an item from a supplier."[77]

Vanderstar terms this type of reciprocity or attempt at reciprocity as "apprehensive", i.e., "the small company apprehends or imagines that its position as a supplier of the large company will be more secure if it is also a customer of the large company."[78] Keeshan describes reciprocity effect as "defensive reciprocity". As he summarizes the theory as adopted in some U.S. antitrust cases, "there is no overt attempt by A to use its buying power; rather, B is aware of A's leverage and channels his purchasing decision."[79] While B's behaviour is voluntary, "this is actually a variant of coercive reciprocity, because B perceives A's buying power, and anticipating A's use of leverage, acts defensively."[80] Keeshan is critical of this theory. He asks why would B, in effect, be willing to give A a gratuitous price cut by increasing its purchases from A where A has unexploited monopsony power.[81] He also points out that a series of assumptions must hold for such defensive reciprocity to make sense: A must be aware of his unused buying power and would just as soon divert purchases from B as bargain for a direct price cut; further B must anticipate A's action by purchasing more from A; and further A's sales department must communicate the news of B's increased purchases of A's output to A's purchasing department.[82] Unlike Keeshan we do not find this so difficult to imagine. A may be blocked from obtaining a direct price cut for its purchases from B, e.g., the market is a oligopoly and B cannot use price discrimination. Second, where A operates a systematic reciprocity program, communication between the sales and marketing departments is part of the

entire strategy. On the other hand, if A does not respond to B's attempt to initiate reciprocity it is hard to imagine B continuing to forbear in its purchasing from A. In the three ITT cases it was argued that because of ITT's anti-reciprocity policy and organizational structure any attempts at unilateral reciprocity would be unrequited.[83] This implies that the object of the inducement to reciprocity must respond positively, i.e., by increasing its purchases from the initiator. Not so--all that is necessary is that the firm possessing unexploited monopsony power continue to make its power credible in the eyes of the initiator. This may be effectively done by negative acts, i.e., by reducing its volume of purchases until the weaker firm responds by increasing its purchases.

Weston contends "the evidence in the leading cases on reciprocity [he cites Consolidated Foods, General Dynamics, and Ingersoll-Rand] ...suggests that overt action is necessary if reciprocal transactions are to be achieved."[84] As we shall see, the U.S. courts have been willing to sustain the Justice Department's attack on reciprocity effect in at least three cases. To do so they have had to be willing to make the necessary inferences we have noted above. Judge Rosenberg in the Ingersoll-Rand case gave the strongest interpretation to reciprocity effect when he stated:

> ...The mere existence of this purchasing power might make its conscious employment toward this end [as a lever to maintain or to increase sales] unnecessary; the possession of the power is frequently sufficient, as sophisticated businessmen are quick to see the advantages in seeking the goodwill of the possessor.[85]

What are the hallmarks of reciprocity effect? First, it can have no meaning unless the dominant party has unexploited monopsony power and wishes to exercise it in an indirect fashion, and that this fact is perceived by the firm's suppliers. In a sense, firms don't wait to be coerced, they offer reciprocal exchanges. These need not be positively reciprocated; rather, the dominant firm in the relationship may make it clear that the "payment of such tribute" will prevent a diminution of the existing volume of purchases from the less powerful partner. Second, it is clear from the first point that the continued existence or expansion of reciprocal exchanges is a conditional arrangement. The minor partner recognizes that the dominant firm's purchases are predicated on its sales to the minor partner. Third, the dominant firm may not operate a systematic reciprocity program. Minor partners are aware of the dominant firm's position and it purchasing leverage. Fourth, almost by definition there is no formal agreement documenting the relationship. The exchanges involve only a tacit understanding. In their impact they may be coercive in all but name, but no overt threats or pressures are

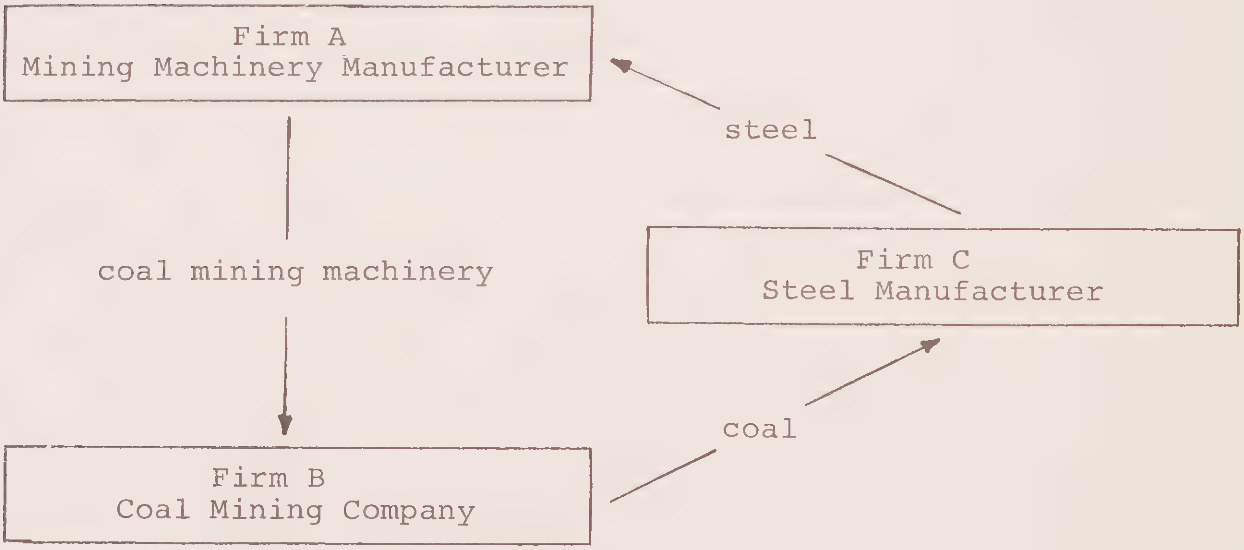
brought to bear. Finally, the prices (*ceteris paribus*) at which the minor partner makes its purchases may *or* may not be above those available from other suppliers. The dominant firm may utilize its market power not so much for increasing its profits, but to obtain a more secure position and stability of sales. This point was made by Sir John Hicks, later a Nobel Laureate in Economics, when he said, "The best of all monopoly profits is a quiet life."[86]

## ADDITIONAL NOTES ON TYPES OF RECIPROCITY

Throughout our discussion we have dealt with the case of reciprocal dealing between two firms or two firms and their affiliates. This has been referred to as primary or bilateral reciprocity. Obviously, reciprocal dealing can be conducted between three or even more independent firms (and their affiliated enterprises). Such forms of reciprocity are referred to as secondary, multilateral, or round-robin reciprocity. Stocking and Mueller describe an example of three-way reciprocity. "If firm A, a potential supplier of firm B, is buying materials from firm C, firm A may obtain B's business if it can persuade C to buy from B. Firm A may be able to do this by threatening to withdraw its patronage from C unless C submits to the arrangement."[87] In the *Ingersoll-Rand* case[88] it was argued that a manufacturer of coal mining (A) might bring pressure to bear on its supplier of steel (C) in order to have C influence its supplier of coal (B) to purchase its mining machinery from A. This can be represented in Chart 2 below.

CHART 2

RECIPROCAL DEALING INVOLVING THREE FIRMS



It seems apparent that when more than three distinct entities are involved the chains of reciprocal buying pressure become inordinately indirect and complicated.

Second, throughout our discussion we have described vertical reciprocity, i.e., where Firm A uses the output of Frim B as an input and vice versa. Betty Bock points out that there is also horizontal reciprocity. In this situation, companies buy from and sell to each other to round out their inventories or product lines. She cites the case Spalding and Rawlings, the first- and fourth-ranked firms in the sports equipment industry. While both were found to be long-line companies, it was also found that they bought and sold equipment from other manufacturers for resale under their own brand names, since each manufactured only a limited set of the lines it sold.[89] She notes that "a second type of horizontal reciprocity occurs in the case of occasional 'swaps' or borrowing and lending of materials or end products that goes on among companies using similar materials and/or manufacturing similar lines."[90] The obvious example is the integrated oil companies who exchange both crude and refined products in different geographic markets.

## CHAPTER 4

## THE EXTENT OF RECIPROCAL DEALING: THE EMPIRICAL EVIDENCE

Reciprocal dealing by businessmen is an ancient and time honored practice. That is not surprising since, in its original and still most common form, it is the practice of taking your business to those who bring their business to you. It is variously spoken of as "mutual backscratching", "doing business with friends", or in the Hawaiian tongue, "Hoomalemale", which has been translated as "you tickle me and I'll tickle you."[1]

### EARLY REFERENCES

While reciprocal dealing is probably as old as business itself,[2] it has actually been dated as far back as the times of the Phoenician traders.[3] Milton Handler, a student of medieval history as well as a prominent antitrust lawyer and teacher in the U.S., has found identical ordiances that unconditionally forbid guild members from patronizing their customers for each of the three craft guilds engaged in making arrows (fletchers), bows (bowyers), and bowstrings (stringers).[4] He also found a number of cases dealing with interpretation of the guild's regulations by the guild courts. For example, in 1415 a fletcher complained that there was only one stringer in Ipswich, and that unless the ban on trading with a customer was lifted, his stringless bow would leave him defenceless against attack by enemies both human and animal. The majority held that a rule of reason must be applied in this case. As Handler puts it, "The court felt that the social interest in prohibiting back-scratching must yield to the higher right of the individual to bear arms for his own protection."[5] In a "blistering dissent" the minority held that, "the ban on customer trading meant exactly what it said and should be enforced with scriptural exactitude."[6] In another case, in Newcastle, "there were two stringers, but both were customers of the same fletchers, whose arrows, because of their superior quality, were much sought after ...since there was no coercion and the sale of arrows was not conditional on the purchase of bowstrings, or vice versa, the court found no violation."[7]

Handler also found instances of complaints made to the guild wardens indicating that "certain fletchers had been over-aggressive, refusing to buy bows unless the bowyers reciprocated by purchasing the fletchers' arrows."[8] He notes that such conduct was "uniformly condemned" by the guilds and the offenders threatened with explusion for their efforts at reciprocal dealings.

Obviously the practice of reciprocal dealing was known to the patron saint of all economists, Adam Smith. In his Wealth of

Nations, originally published in 1776, he inveighed against the practice, saying,

> It is the most underling tradesmen only who make it a rule to employ chiefly their own customers. A great trader purchases his goods always where they are cheapest and best, without regard to any little interest of this kind.[9]

U.S. TURN OF THE CENTURY

In terms of time we must make another gigantic leap as we trace the indirect evidence of reciprocal dealing through the academic and professional literature. We now draw from F. R. Finney's dissertation in which he traced discussions of reciprocity in the marketing and purchasing literature back to just after the start of this century.[10] The first mention he was able to find, a one-paragraph treatment, was in a book on purchasing published in 1915.[11] He indicates the first substantial treatment, which described the advantages of reciprocity, was in a purchasing text published in 1922.[12] Finney notes that even the early books on purchasing or procurement for railroads (e.g., 1880, 1911) did not mention reciprocity.[13] Similarly two major general purchasing texts published in 1928 did not include any discussion of reciprocal buying.[14] Finney makes an interesting observation about his review of the early literature.

"There are many more books on marketing and selling than on purchasing, yet it is remarkable to find that references to reciprocal dealing in marketing books are fewer than in purchasing books--remarkable only because all authors agree that reciprocity is a sales strategy, not a procurement one."[15]

He notes that the first reference in a marketing or sales text did not occur until 1931 and that was a two-page treatement which generally condemned it as a sales or purchasing technique while admitting that the practice was quite extensive.[16] Two marketing texts published in 1932 made only brief reference to reciprocity.[17]

Returning to the purchasing literature in the form of articles in the trade or academic journals, Finney states:

> ...more than a dozen comments on reciprocity appeared just before and just after the court cases (one in 1931 and one in 1932) and the I.C.C. hearnings in the early 1930's. After this period interest must have waned, as almost nothing was written for publication in a periodical for the next twenty-five years. Activity began in the late 1950's....[18]

In general these articles condemned reciprocal dealing as a poor business practice.[19] Then, Finney says:

> ...in 1933 Howard T. Lewis in the text Industrial Purchasing introduced what seems to have been the general attitude of purchasing agents toward the practice ever since; a rather ambivalent view which, put simply, is that reciprocity is widely practised, it is seldom good and often bad, it has a definite unwholesome aura about it, but sometimes it can be a useful company strategy.[20]

With respect to the marketing literature, a text published in 1935 gave two pages to the subject of reciprocity.[21] Finney indicates that the texts of the 1940's, 1950's, and 1960's treatment of reciprocity was very brief, even offhand.[22] Only one published in 1967 devoted as much as five pages to the subject.[23] As for articles Finney's survey disclosed virtually nothing until the late 1950's and very little in the way of articles until the mid-1960's.[24]

Finney states that most of the major purchasing texts dealt, until the early 1960's, briefly with the subject along the lines of Lewis' 1933 text cited above.[25] Of the texts that he reviewed up to the early 1960's Finney notes, "not one of the entire group said anything about possible illegality under the antitrust laws."[26] This was despite the fact that the FTC had declared reciprocal buying illegal in three cases in the 1930's.

## THE 1930'S

We are getting ahead of a strict chronological development of the evidence on reciprocal dealing. Late in 1932 the Interstate Commerce Commission published a report dealing with the practice of reciprocity by railroads and their customers.[27] The I.C.C. noted that it was "quite a common practice for carriers to receive bids, and after determining the lowest bid to advise other bidders thereof, and then to divide purchases proportionately among those bidders who are willing to meet the lowest bid. The division is made according to the commercial tonnage of the respective bidders which has been or is about to be routed over the lines of the purchasing carrier."[28] It is evident from the I.C.C. report that reciprocal dealing was organized and quite systematic in many cases, e.g., "Generally the purchasing department of a carrier keeps the traffic department advised currently of the firms from which purchases are made and the amount of money involved. This information is used in soliciting traffic. Some of the larger shippers send periodically to the various carriers a list or summary of the shipments which they have routed only the respective carrier lines. Such reports are usually followed by correspondence or personal solicitation with a view to influencing purchases."[29]

It is obvious from this summary that both sides were playing the game. In the two early cases concerning reciprocity and the railroads, Waugh Equipment (1931)[30] and Mechanical Manufacturing (1932)[31], the initiative for reciprocal dealing came from the shippers, meat packers in both cases.

The I.C.C. concluded that reciprocity was increasing between railroads and their shippers: "Although the manufacturers and dealers have insisted for many years that the carriers recognize their patronage in awarding purchases the practice became much more general in the past few years."[32] Perhaps the Depression induced shippers to stress reciprocity as a means to maintain their falling output.

The I.C.C. stated that "practically all of the witnesses testified that traffic was given consideration in awarding purchases only when 'price, quality, and service' are equal." The documentary evidence did not support this contention. The "correspondence between the traffic and purchasing departments discloses no such qualification...."[33] The Commission concluded that, if what we call the ceteris paribus conditions were enforced, it was only because purchasing officers had "sufficient authority to adhere to the policy regardless of the expressed or implied insistence of the traffic department."[34] While it was generally denied that carriers paid a premium for certain purchases from shippers, "there were disclosed instances where such higher prices were paid for traffic reasons."[35] The I.C.C. also found instances of diversion of traffic in response to reciprocal dealing or the failure to engage in reciprocity.[36] The I.C.C. concluded that reciprocity, "sound and logical when indulged in strictly private business, becomes a matter of concern when transplanted to a quasi public enterprise because the waste incurred thereby becomes a liability for which the public must pay."[37] As the I.C.C. saw it, reciprocal dealing "is extremely unfortunate and burdensome because it causes a shifting rather than an increase in traffic. Stated otherwise, it succeeds only in making the handling of existing traffic more expensive."[38] The I.C.C. recommended that competitive bidding be required for all railroad purchases and that the carriers be required to award the entire contract to the low bidder. The Commission also recommended that shippers no longer be allowed to specify the route over which their shipments be transported.[39]

Following the I.C.C.'s report and the three successful cases brought by the Federal Trade Commission in 1931, 1932, and 1937,[40] one of the very few articles on reciprocity, and almost certainly the only empirical article, for the next two decades was Howard T. Lewis paper published in 1938.[41] His sample contained 251 firms and he obtained replies from 176 purchasing officers, 43 sales managers, and 32 general management executives.[42] He indicated that "to a greater or lesser degree reciprocity is

found in nearly every type of manufacturing business as well as in banking institutions and insurance, public utility, transportation, and construction companies."[43] With respect to the manufacturing sector "it appears to be particularly prominent among manufacturers of machinery and other iron and steel products, electrical supplies, paper and printing, chemicals (including paints), and non-ferrous metals, petroleum and rubber."[44]

Of the respondents, 41 percent of sales executives and 62 percent of the general management executives favored reciprocal dealing as a policy. Some 82 percent of those in favor endorsed reciprocity as a means of obtaining "a share in a company's volume of purchases when (its) price and quality are competitive."[45] The remainder, 18 percent, indicated they would use reciprocity to increase their own sales even when prices were "somewhat higher than competitor's." Two-thirds of those favoring the use of reciprocity on a ceteris paribus basis saw it as a means of obtaining "an interview for salesmen when an interview would not otherwise be granted."[46] This argument is one of the cornerstones of the trade relations functions--"obtaining access" so the firm can "tell its story".

Lewis found 44 percent of the purchasing officers' replies indicated that their firms engaged in three-way or even more complicated forms of what has been called round-robin reciprocity.[47] He gave three extended examples of how such arrangements can work in practice. Surprisingly, Lewis does not give the percentage of purchasing agents, who constituted 70 percent of his sample, whose firms engaged in any form of reciprocal dealing.

With respect to the question, "Do you have a definite procedure for handling reciprocal purchases and sales?", some 70 percent of the purchasing agents replied, "No".[48] Further, 55 percent of the purchasing agents replied, "that they carried on no special accounting that indicates the extent to which reciprocal purchasing results in extra material costs."[49] One-half the purchasing officers indicated that the locus of decision-making as to reciprocal dealings rested with themselves and the sales manager jointly, 6 percent said the sales manager alone, 14 percent with some other executive, and 11 percent said it rested with a special committee or department.[50] We shall see in later studies and in the U.S. cases that the control over reciprocal dealing resided with top level executives rather than the sales and/or purchasing executives. Trade relations departments to coordinate reciprocal dealing were in existence in the 1930's. Lewis states, "A good many companies have set up similar departments...designed to deal with reciprocity as a real and distinct issue as well as to centralize its control. It is probably safe to say that there is a definite trend in this direction."[51]

Whatever the extent of reciprocity, Lewis found businessmen extremely reticent about the issue:

> Some deny that their companies practice it, even in the face of a common knowledge to the contrary. Others deny it publicly, but will occasionally admit in confidence that they do follow it, and even describe in considerable detail their method of handling the problem. Still others, although they state quite frankly that they have such a policy, refuse to discuss even the general organization and procedure for handling the problem.[52]

THE 1950'S

In March 1954 Neuhoff and Thompson published the results of a survey of 163 companies in the U.S.[53] The reciprocity policies of the companies fell into three categories:

1. "Reciprocity as a deliberate sales tool"--less than one-fifth of the sample were put into this category. "Many executives who report that reciprocity is a company policy state that they are not happy with the arrangement. These men say that their companies are involved in reciprocal arrangements merely as a defense and would not engage in the practice if they were not forced to string along, either by custom of the industry or pressure from customers."[54] The authors point out that even where it is a company policy, reciprocity is "used with considerable discretion" and it is "rarely the dominant factor in any transaction."[55] Most of the firms in this category "report that reciprocal buying and selling effects only a small part of their business."[56]

2. "Reciprocity or, more accurately, 'favoring one's friends' enters the picture when all other factors are equal"--some 60 percent of the sample were placed in this category by Neuhoff and Thompson. For such firms, "each transaction is treated on its own merits and reciprocity enters the picture only as a result of the natural desire to establish and maintain friendly relations with people with whom business is done...Formal policies on the subject usually do not exist."[57] A steel executive's words appear to summarize the approach of the firms placed in this category: "Reciprocity...is a desirable practice as long as the purchases are based on price, quality, and service being equal... [the] discounts to us are the same from all mill and mine houses ...If their service is not competitive we will quit purchasing from them."[58]

3. "Neither reciprocity nor friendship consciously enters any sales transaction"--one-fifth of the firms in the sample wanted both their sales and their purchasing transactions to be based on merit alone."[59] In some cases firms adopted this

stance because "reciprocity has no place in business" while others were of the view, "We would if we could but we can't."[60] One might say that the latter were pure for lack of opportunity.

While a diversity of policies toward reciprocity were observed, "the great majority of the 163 reporting executives believe that making sales on the grounds of reciprocity alone stifles competition and runs against the grain of the free enterprise system."[61] Even the companies that practice reciprocal dealing "often criticize it".[62]

In terms of the responsibility for administering reciprocal dealing, Neuhoff and Thompson indicate that in about one-third of the reporting companies it is handled jointly by sales and purchasing executives. Sales and purchasing executives alone were responsible in one-quarter of the companies, and in the remainder reciprocity was handled through top management committees.[63] Compared to Lewis' 1938 paper, we notice somewhat closer coordination between purchasing and sales executives in the administration of reciprocal dealing.

Perhaps one of the most frequently cited papers on both the theory of reciprocity and its extent in the United States is one published in 1957 by Stocking and Mueller.[64] After briefly reviewing Lewis' results, the I.C.C. report and the three FTC cases in the 1930's, Stocking and Mueller provide considerable evidence of the nature and extent of reciprocal dealing by du Pont from the 1920's through World War II. Apparently some executives of du Pont wanted to use that company's connection with General Motors to combine the purchasing/selling capabilities of the two giants. However, this was apparently not a highly successful strategy.[65] The paper also documents the reciprocal dealings of the United States Rubber Company from the late 1920's through World War II. Apparently as late as 1953 that company had an active reciprocity program.[66] Also discussed is the preferential treatment du Pont and U.S. Rubber accorded each other in buying and selling.[67] Finally the two authors look at the extent to which General Motors engaged in reciprocal dealing --with particular reference to G.M.'s rapid growth to dominance in the diesel electric locomotive field.[68]

## THE 1960'S

For evidence of the extent of reciprocal dealing in the United States, the most frequently cited article is one that appeared in Purchasing in 1961.[69] This trade journal surveyed 1,000 purchasing agents, 1,000 sales managers, and about 200 directors of trade relations.[70] The statistical findings were based on replies from 300 purchasing agents.[71] Fifty-one percent of the sample replied, "yes" to the question, "Is reciprocity (or trade relations) a factor in buyer-seller

relations in your company?" The proportion answering "yes" increased from 46 percent for those with sales volume of under $10 million to 62 percent in the $10 million to $50 million range to 78 percent in the over $50 million range. One hundred percent of the sample indicated that reciprocity was a factor in the chemical, petroleum, iron and steel, and other basic raw material industries. In iron and steel, 40 percent of the purchasing agents indicated that over 30 percent of their sales volume came from their company's suppliers. In chemicals, petroleum and other process industries, 16 percent of the purchasing agents said suppliers accounted for more than 20 percent of their sales. For the total sample 64 percent said sales to suppliers accounted for under 5 percent of total sales.

One-quarter of the total sample indicated their firm had been involved in "secondary trade relations problems". In miscellaneous nonmetallic products the percentage was 40 percent in chemicals, petroleum and other process industries it was 64 percent, and in iron and steel it was 38 percent. The proportion involved in secondary trade relations activities increased with size: 20 percent for firms with sales under $10 million, 28 percent for those in the $10 million to $50 million range to 41 percent with sales of over $50 million.

Sloane's survey supports the often repeated point that recession and excess capacity, particularly in capital industries, is a spur to reciprocal dealing as a means of maintaining sales. He states, "During the 1960-61 recession--as in previous postwar slumps--salesmen and their sales managers exerted heavy trade relations pressures on purchasing agents as a way to increase sales volume. One trend that was particularly noticeable last year and early in 1961 was the use of purchasing agents to help sell their company's products."[72] Thirty-five percent of the sample indicated that in recent months they had noticed an increase in trade relations problems because of excess capacity or declining sales. In chemicals, petroleum and other processes the proportion was 63 percent; in iron and steel it was 69 percent. Some 62 percent of the sample indicated their company's purchasing agents "mention company products to suppliers" to assist in soliciting business. Twenty-six percent "provide lists of suppliers by dollar volume." In chemicals, petroleum and other process industries the proportions were 71 percent and 71 percent respectively (respondents could give more than one answer) and in iron and steel they were 63 percent and 39 percent respectively. Most writers agree that it is the provision of detailed purchase data by supplier to the sales department together with contacts between the two firms wishing to engage in reciprocity that is the hallmark of systematic reciprocity. Finney, in an article drawn from his Ph.D. thesis on reciprocity, puts it this way: "if trade relations as practised by a given firm requires the use of purchasing data, the firm is engaged in organized reciprocity.

If purchasing data is not required by its trade relations office in any way, the firm is not practicing reciprocity. I know of no trade relations departments presently functioning in the latter manner."[73]

Obviously reciprocal dealing, perhaps even systematic reciprocity can go on without a trade relations department. "Only 4 percent of all companies taking part in the study report having separate trade relations departments. The figure doubles for firms with sales over $50 million."[74] At the same time the author states, "More than 200 major industrial companies have trade relations departments."[75] Apparently the Trade Relations Association had its beginnings in 1960 when a group of trade relations executives had an informal meeting in Whiteface, N.Y. Sloane states, "Around 60 representatives from many of the nation's largest companies assembled for a one-day trade relations forum."[76] Sloane also indicates that the American Management Association had an "exploratory closed-door session" on the trade relations function at about the same time.[77] Finney states that the Association was formed in December of 1962.[78] A Fortune article published in 1965 stated that the Trade Relations Association was formed at the informal suggestion of a Federal Trade Commission lawyer attending a meeting of the A.M.A.[79] In any event, by 1963 at the Association's annual meeting, 118 firms sent representatives.[80] Edwards indicates that "of the firms represented, 105 were among the thousand largest manufacturing enterprises, as measured by sales; 90 were among the 500 largest; and 52 were among the 200 largest. The Association's board of governers consisted of officials from 9 firms, all among the 200 largest, each of which produced products in from 32 to 128 product classes."[81]

The indirect evidence suggests that reciprocal dealing, as evidenced by the growth of the trade relations function, expanded during the 1960's. In the Fortune article referred to above we are told, "...about 70 percent of the companies on Fortune's 500 list now employ managers whom they euphemistically call 'trade relations men', and who adroitly, and more or less openly, conduct reciprocal affairs." They go on to point out that in some industries such as oil, steel and banking, "reciprocity belongs to a traditional way of life".[82]

At that time the authors indicate that the Trade Relations Association had 141 members from 135 large companies. The Association also "has a large platoon of nonmembers including the trade relations men from U.S. Steel, Shell Oil, and G.E. Such nonmembers may show up at a gathering to meet friends and give advice, but they aren't there officially "--even if their companies pay for their hotel bills.[83]

An article published in Sales Management in February 1967 places the membership in the Trade Relations Association at 150.[84] It also indicates that within the Association 43 percent of the top 500 companies are represented.[85] One executive, a member of the Association, is quoted as saying that 75 percent of the trade relations men come from the sales and marketing functions and that the average member company has had a trade relations department for from three to five years.[86]

In September 1968, Dun's Review cites an FTC spokesman as saying that under various guises 80 percent of the largest corporations in the U.S. and a number of medium- and smaller-sized ones had trade relations departments.[87] The president of the Trade Relations Association is quoted as saying the number of trade relations departments in U.S. corporations had increased "by about 25 percent" over the previous five years.[88] Having reviewed the government's increased activity against organized and systematic reciprocal dealing, the author of the article formulates the problem this way:

> But can reciprocity be eliminated by government edict? Joseph Kennedy of the Trade Relations Association thinks not. He shrugs: "They will go underground. People want to do business with friends."[89]

In the August, 1967 edition of the Journal of Purchasing, Jack R. Dauner published the results of his survey of the purchasing agents of 72 firms in 22 Standard Industrial Classification two-digit industries in the St. Louis area.[90] Twenty-three of the firms had sales of $1 million to $9.9 million while 30 had sales of $100 million or more. Two-thirds of the firms were contained in six of the two-digit groups: fabricated metal products, transportation equipment, chemicals and allied products, electrical machinery, food and kindred products, and primary metals industries. Dauner states, "This very closely resembles the ranking of these same groups in the 1964 Annual Survey of Manufacturers".[91]

Forty-three percent of the purchasing agents stated they believed reciprocity had moderately or greatly increased since the early 1960's. Twenty-nine percent indicated there had been no change, and eleven percent stated that the use of reciprocal dealing had levelled off since the early 1960's. Only 1.4 percent said there had been a noticeable decline (15.2 percent of the sample gave no response).[92] Like previous researchers Dauner found that "the extreme sensitivity of the subject [reciprocity] was evident", yet he refused to waffle behind the euphemism of the term 'trade relations', and his questionnaire was labelled Reciprocity Study.[93] Dauner indicates that a majority of his respondents defined the term reciprocity along the following

lines: "Buying from those who buy from you, providing price, quality, and service are competitive."[94]

Why does a company use reciprocity? The following percentage of respondents agreed with the reasons set out below:[95]

| | |
|---|---|
| "Excess capacity" | 93.1 percent |
| "To reduce per unit cost" | 88.9 percent |
| "To increase incremental profit" | 86.1 percent |
| "Case of selling--fewer accounts" | 80.6 percent |

While just over half (37 of 72) of the purchasing agents indicate they thought a company should have a stated policy on reciprocity, only 38 percent of those responding in the affirmative operated under any form of policy, and for the most part such policies were unwritten.[96] Sixty-eight percent of the respondents wanted approval of reciprocal dealing to be the responsibility of top management. Forty percent wanted it placed in the hands of the president.[97] Only 8.3 percent of the firms in the survey had a director of trade relations by that name. At least as frequently, Dauner found, the policy was coordinated by a vice president or the president.[98] Dauner also found widespread misgivings about the ethics of reciprocity.[99] The desire of the purchasing agents to have clear company policies and to have senior executives take the responsibility for reciprocal dealing is evidence of their ethical ambivalence or severe discomfort. Even those who argue reciprocity is ethical do so defensively. One reads their words and the phrase "Methinks he doth protest too much" comes to mind.

Dauner's respondents saw both advantages and disadvantages in reciprocal dealing. He states, "By far the most frequently mentioned advantage of a reciprocity program was the potential contribution to overall corporate sales and profits."[100] Disadvantages centered around "the tendency to decrease competition," "the tendency to produce higher prices," presumably in purchasing, and "the tendency to restrict the purchasing function."[101]

Although the proportion of nonresponses was higher for these questions than others, from the data provided, Dauner found that the "mean percent of sales resulting from reciprocity was established at 8.5 percent while the mean percent of purchases was pegged at 12.6 percent."[102]

Thirty-nine percent of Dauner's sample indicated they thought teciprocal dealing would increase moderately or greatly in the five years following the survey. Thirty-two percent believed it would remain the same while 6.9 percent thought there would be a noticeable decline.[103] "Though the term and practice are generally disliked by the business community, the purchasing agents indicated that the practice of reciprocity would continue to grow even with increased pressures from the Federal Trade

Commission and the Justice Department."[104] Officials in Washington concluded differently after the flurry of activity against reciprocity in the late 1960's and early 1970's. They suggested that the relative ease with which they obtained consent decrees with almost three dozen corporations and the very few litigated cases concerning systematic reciprocal dealing indicates that the practice was not very valuable to its practitioners if it was abandoned so easily.

Finney, in the preparation of his thesis, considered and rejected any attempt to gather quantitative data from a large sample by the use of questionnaires "for the reason brought out so clearly by the discrepancy between written and spoken reports on reciprocal dealing." He continues, "Businessmen are reluctant to put in writing facts which might very well be embarrassing or even dangerous. They hesitate to do so candidly on this subject even if not identified."[105] In his study Finney conducted personal interviews with approximately 30 business executives.[106] The divergence between their written views and the information obtained by interview was greatest for sales and marketing executives rather than purchasing executives.[107]

On the basis of his admittedly limited sample Finney found reciprocal dealing was widespread.

> Every company interviewed which marketed in the industrial field (even partly) practiced reciprocity to some degree. Most of the companies interviewed had been purposely selected from industries which were in a position to practice reciprocal dealing and included representative companies in shipping, railroading, chemicals, petroleum, basic metals, rubber, banking, heavy machinery, paper and packaging, printing inks, plastics, and miscellaneous industrial equipment. By far the greater proportion consciously used reciprocity as a sales strategy.[108]

Finney continues, "Those who did not use the argument of reciprocal buying as a sales strategy where applicable refrained either because the benefits would be too small, or, more importantly, because they felt it was illegal under the anti-trust laws and avoided it out of caution."[109]

In 1969 the Federal Trade Commission published its lengthy Staff Report on Corporate Mergers. In Chapter 6 of the Report 74 pages are devoted to an analysis of "business reciprocity" in which strong conclusions as to the anti-competitive effects of reciprocity are drawn.[110] In drawing its conclusions the FTC did not conduct or commission any new research into the extent and/or impact of reciprocal dealing in the United States.

As evidence of the extent of reciprocity the Report cited the 1965 Fortune article, the 1961 Purchasing survey and the Waugh Equipment case all of which we have referred to above.[111] In addition, it referred to the practice of reciprocity or the alleged practice of reciprocity by about 40 firms. The following were cited:

1. Four conglomerate merger cases in which reciprocity was a factor; White Consolidated-Allis Chalmers, Northwest Industries-Goodrich, ITT-Hartford, and LTV-Jones & Laughlin.[112]
2. Four companies from which the FTC had obtained assurances of voluntary compliance in respect of reciprocity: American Standard, Union Bag-Camp Corp., GAF Corp., and Chase Bag Co.[113]
3. Thirteen corporations (unnamed) which the FTC had under investigation for apparent use of reciprocal dealing.[114]
4. Fifteen companies listed in a recent court decision as practising reciprocity;Alcoa,DuPont, Cities Services, Humble Oil, Monsanto, Pittsburgh Plate Glass, Texaco, Goodrich Tire Co., FMC Corp., Reichold Chemical, Kerr-McGee, Allied Chemical, American Oil, Shell, and Tenneco.[115]
5. Two corporations involved in Sherman Act reciprocity cases; U.S. Steel and General Tire.[116]
6. Four more detailed case studies; General Dynamics, American Standard, GAF Corp., and the tire industry--principally General Tire.[117]

Paul McAvoy wrote a strong critique of the Report. He points out, as we have done, that there was "no information collected by the FTC staff on its [reciprocity's] general use in relation to mergers by the large 200 companies."[118] Although he is referring to the entire report his conclusions might also be ascribed to the treatment of reciprocal dealing: "This Merger Report is so scant in evidence, and the evidence so weakly supports the 'reasons', that this committee one of sadly concludes that we do not know the competitive effects from large conglomerate mergers."[119]

In the latter half of 1969 or early in 1970, as part of the evidence submitted in the ITT-Canteen case, 37 companies, described by the judge as "representing a cross-section of American business," gave sworn answers to questions regarding their policies toward reciprocal dealing. The following 22 companies indicated they had written policies against reciprocal buying or channelling purchases to customers to induce reciprocal arrangements: American Airlines, AMF, American Oil

Company, Atlantic-Richfield, C&H Sugar, Campbell Soup, Eastern Express, Humble Oil, IBM, Kraftco, Marcor (formerly Montgomery Ward), Mobil, Monsanto, Owen Illinois, Reynolds Metals, SCM Corp., Shell Oil, Union Oil, and Uniroyal. Another nine firms stated they had unwritten policies against reciprocity: Anheuser-Busch, Eastern Airlines, Fairmont Foods, Flintkote, Hershey Foods, Liggett & Myers, National Biscuit, Standard Brands, and Whirlpool. "While 6 of 37 companies stated that they had no general policy prohibiting reciprocal dealing, four of them answered "no" to a specific question asking if they would channel their purchases to Canteen in order to induce ITT to buy from them."[120]

THE 1970'S

In Jesse W. Markham's study, Conglomerate Enterprise and Public Policy, we find more systematic empirical evidence on reciprocal dealing. Markham drew his sample from the 1969 Fortune 500 and 100 other corporations on a list of "The Associates of the Harvard Business School."[121] He received 211 usable responses to his survey, which appears to have been conducted during 1971. For 117 of this number he was able to match up his results with Berry's 2- and 4-digit index of diversification.[122] Markham asked two questions to measure the existence of reciprocal dealing by the firms in his sample: (1) he asked whether the firm had a trade relations department for, as he points out, "It has been urged in the literature that the existence of a trade relations department in a company may at least be highly suggestive of the practice of reciprocity."[123] He also notes that "large and diversified [enterprises] could scarcely practice reciprocity without creating an organizational unit responsible for communicating the relevant supplier and customer information within the company. There appears to be some evidence that trade relations departments have performed this function."[124] (2) As a check on question 1, "companies were asked to indicate whether they regularly circulated supplier and customer lists to officers responsible for purchasing."[125]

Markham received replies to question 1 from 195 firms of the 211 in the sample. Thirty-one or 16 percent indicated they maintained trade relations departments.[126] With respect to question 2, Markham found that "70 percent of the 31 firms with trade relations departments routinely circulated customer and supplier lists to purchasing officers."[127] Of the 164 firms which said they did not have a trade relations department "nearly 80 percent reported that they did not routinely circulate customer and supplier lists."[128] Therefore, Markham concluded that "inferences concerning reciprocity based on trade relations departments tend to understate the extent to which reciprocity may be practiced. The number of companies reporting that they routinely circulated supplier and customer information exceeded the number reporting the maintenance of a trade relations department"[129]

Markham then set out to see if reciprocity was positively associated with conglomerate enterprise, i.e., diversification. Using Berry's index of diversification (both 2- and 4-digit for 1965) he found that for both the 31 consumer goods and the 58 producer goods firms the diversification indexes were higher for the firms reporting no trade relations departments.[130]

Markham also found that the average number of diversifying mergers between 1961 and 1970 by firms not reporting a trade relations department was greater (particularly among producer goods firms) than among those with a trade relations department.[131]

These results would appear to suggest that reciprocity, as evidenced by a trade relations department, is less likely to be practised by more highly diversified corporations. This flies in the face of the idea that increased diversification provides a greater opportunity for reciprocal dealings. However, it should be pointed out that we should distinguish between the number of potential opportunities for reciprocity and the absolute volume of potential trade involved, together with the cost of comprehensive reciprocal dealings as a firm becomes highly diversified.[132]

After examining both the absolute and proportionate number of diversifying acquisitions, Markham concludes "that reciprocity is more likely to be practised by companies long established in their traditional product lines."[133] This is consistent with his earlier observation that the industries indicated as particularly prone to reciprocal dealing (railroads, oil, steel, rubber tires, investment underwriting, and banks) "are not generally regarded as striking representatives of conglomerate enterprises." The available factual evidence, Markham states, "only tends to confirm that reciprocity is practised, and that its practice is not confined to or even especially characteristic of large diversified companies."[134]

While reciprocal dealing almost certainly did not disappear in the early 1970's, the antitrust attack on reciprocity did account for the demise of the Trade Relations Association in late 1971 or early 1972.[135] Many of the consent decrees obtained by the Department of Justice in reciprocity cases required the companies to give up their membership in the Association.[136]

In November 1973, Bird and Shepherd published the results of a survey of a sample of 139 purchasing managers and 81 sales managers, both samples being drawn from the Industrial Directory of Virginia (1971-1972).[137] A total of 350 questionnaires were sent to purchasing managers and 250 were sent to sales managers in manufacturing firms with SIC codes 2100 to 3900.

Some 17.4 percent of the purchasing managers and 23.5 percent of the sales managers indicated that their firm used reciprocity

in either buying or selling.[138] No data were obtained on the volume of purchases or sales involved in reciprocal dealing. With respect to the question, "Do you favor passing a federal law to prohibit or limit the use of reciprocity in buying and selling between business firms?" 26.6 percent of the purchasing managers and 35.8 percent of the sales managers replied, "yes". Some 16.6 percent of purchasing managers and 12.3 percent of sales managers were "undecided". At the other end of the spectrum, 23.8 percent of the purchasing managers and 24.7 percent of the sales managers would fight directly or through a trade association any new proposed anti-reciprocity bill.[139]

The ethical ambiquity of reciprocity is indicated by the responses to other questions posed by Bird and Shepherd. About two-thirds of both purchasing and sales managers said they believed it should be legal for business to use reciprocity "when both buyer and seller benefit", but only 14 to 21 percent thought reciprocity should be legal "when one party gains and the other loses", "when both parties stand to lose", or "when a third party is forced out of the market as a result of two other firms' use of reciprocity".[140]

One of the most interesting findings in Bird and Shepherd's survey is that reciprocity appears to find <u>less</u> favor with sales managers than with purchasing managers. A higher proportion of sales manager favor a federal law prohibiting or limiting reciprocal dealing. In theory, one would expect sales managers to want few restrictions, if any, on the use of reciprocity while purchasing agents would not favor reciprocal dealing as it implies interference in the purchasing based on the usual price, quality, service criteria.

On the basis of a survey of purchasing managers, also published in November,1973 <u>Purchasing</u> magazine declared, "Reciprocity is rarely a major problem today."[141] Only 2 percent of their sample (size and method of selection unspecified) "claimed major difficulties with reciprocity". Thirty-one percent described reciprocity as a "minor" problem--for the remaining it was not a problem at all.[142] The reason given for this result is as follows: "If top management lays down definitive rules regarding reciprocity, purchasing managers feel little pressure to give into customers' demands."[143]

This reasoning suggests that many purchasing managers who engage in reciprocity do so because of the initiative of "the other side". This is in accord with Finney's finding that "in many industry situations the purchasing department becomes involved in reciprocal buying purely in a defensive manner. These companies, for varying reasons, are not in a position to use reciprocity as a major sales weapon, but their customers use the fact that they <u>are</u> customers to solicit reciprocal orders."[144]

In conjunction with a firm company policy regarding reciprocity or as an alternative to such a policy, Purchasing states that two-thirds of their respondent firms "train buyers in the legal aspects of reciprocity and teach them how to handle the pressure themselves."[145] Between 1969 and the end of 1975 the Department of Justice obtained about three dozen consent orders regarding systematic reciprocal dealing. Apparently part of the impact of these was to assist reluctant firms to resist or to reduce the impact of inducements to reciprocal dealing.

Another important result from Purchasing survey is that 18 percent of the sample indicate that reciprocity is less of a problem than it was five years earlier. Eleven percent indicated it was more of a problem; the remainder saw no change.[146] As to the extent of reciprocal dealing at the time of the survey, only a chart is provided with no textual elaboration. It is labelled, "How much business does purchasing give its customers?" Thirty-seven percent of the respondents said it was "not a factor in selection", 34 percent said "some", 27 percent said, "most", and 2 percent said "all".[147] These figures would suggest that reciprocity is still a significant factor in American business--the incursions of the law notwithstanding. Professor John Narver in his testimony before the Royal Commission on Corporate Concentration two years later said "reciprocity is a very widespread event or practice in industry".[148]

## SUMMARY

Unfortunately, most of the "empirical evidence" of the extent of reciprocal dealing is impressionistic, unscientific, and indirect in nature. For lack of large scale scientific sampling of firms using carefully tested questionnaires and interview schedules we have had to present indirect evidence such as surveys of academic, professional, and trade literature from which we tried to infer the extent of this business practice. We are forced to cite the estimates (guesstimates?) of businessmen and academics. Even the surveys of purchasing or sales managers are questionable methodologically, do not incorporate very large samples, tend to reflect attitudes and beliefs rather than "hard" data and certainly lack comparability over time. The necessity to make inferences from weak data is regrettably present.

Reciprocal dealing between business firms has a long history. What evidence we have, and it is far from satisfactory, suggests that despite the attempts by U.S. antitrust autorities to constrain systematic reciprocity, the practice is probably fairly widespread. While the U.S. authorities may have been successful in getting consent decrees, assurances of voluntary compliance, or litigated decisions against about 40 large firms in regard to systematic reciprocity, they probably have not changed the extent of unsystematic, voluntary, or casual reciprocal dealing.

What information we have suggests that the practice of reciprocal dealing grew in the U.S. through the late 1950's and the 1960's. It probably levelled off in the early 1970's--particularly in the form of coordinated and organized efforts by large firms. However, evidence of the _extent_ of reciprocity (i.e., the number of firms engaging in it to a greater or lesser degree) tells us little of the _significance_ of reciprocal dealing. Estimates of the _volume_ of trade involved are almost nonexistent, and their reliability is definitely suspect. By the significance of reciprocal dealing we refer to its impact on allocative efficiency (price and output) in specific industries, and whether it results in higher or lower purchasing/selling costs for individual firms (more generally, the managerial implications of the practice). In addition to these factors any analysis of its impact should look at such dynamic factors as its effect on barriers to entry, entrenchment of market power, and increased levels of concentration as firms merge to acquire reciprocity leverage. Quite simply the empirical evidence we have with exception of a handful specific case studies, does not begin to assess the significance of reciprocal dealing in the United States.

By and large, the evidence we have surveyed indicates that businessmen long before reciprocity came under legal attack, were of the view that the practice was ethically questionable. While it has its defenders, often trade relations executives, reciprocal dealing is condemned as contrary to the free enterprise competitive ethic by the majority of businessmen. In addition, many question its efficacy as a strategy for the individual firm.

Although the U.S. Government's interest in reciprocity as a potentially undesirable trade practice in the 1960's was a weapon to attack conglomerate mergers, the evidence we have examined does not indicate that reciprocal dealing is primarily associated with large diversified firms. No systematic quantitative comparisons are possible, but for every conglomerate one could cite as engaging in reciprocity one could cite a non-conglomerate enterprise engaging in the same practice.

# CHAPTER 5

# ECONOMIC AND MANAGERIAL ASPECTS OF RECIPROCAL BUYING

The chapter will examine both the economic and the managerial aspects of reciprocal dealing. Unfortunately we are forced to deal with a large number of variables or factors one at a time using the convenient *ceteris paribus* assumption. At best we can handle a few variables simultaneously and so more closely approximate the complexity of real world situations. However, we hope that the discussion will provide a useful check list for analysts and policy-makers to use in appraising the economic significance of reciprocal buying arrangements.

What do we mean by *economically significant* instances of reciprocal buying? Stocking and Mueller define them to be "when a firm can make sales in this way that it could not otherwise make or could make only at greater costs."[1] Following Stigler, Roger D. Blair states that, to be meaningful, reciprocity "must be defined as the particular subset of all mutual trading that is unexplained by either chance or ordinary cost-quality advantages."[2] This is consistent with Stocking and Mueller.

We begin with an analysis of the factors which facilitate (or inhibit) reciprocal dealing by business firms. In the second section we discuss a number of broader analytical issues raised in the economic analysis of reciprocity, including a look at the dynamic implications of reciprocity. In the final section we deal with the managerial aspects of reciprocal dealing.

## FACTORS FACILITATING RECIPROCAL BUYING

### DIVERSIFICATION

It is axiomatic that as a firm diversifies its operations into several or many industries through internal growth or by acquisition, the number of opportunities for reciprocal dealing increases. This occurs because the probability of finding that the firms it sells to are also suppliers or potential suppliers increases when a firm makes many products. Using the 1958 U.S. input-output table, which included 63 goods-producing industries, Lee Preston shows how growth resulting in diversification increases the number of a firm's potential reciprocal arrangements.[3] If a single firm operating in one industry has ten input and ten output contacts (about one-half the average), in a 63-industry economy the probability that a reciprocity possibility will occur is 0.3.[4] Suppose this firm by internal growth or by merger obtains a position in another industry with an equal

number of different buying and selling contacts. Now the probability of the diversified firm having at least one reciprocity possibility is 0.88.[5] Since many mergers involve firms operating in a number of industries, it is obvious that the probability of multiple instances of reciprocity potential will be high.

Diversification, in addition to increasing the potential for reciprocity by increasing the number of "contact points"[6] between firms, also increases the magnitude of reciprocity opportunities. Stocking and Mueller point out that, "by making other products requiring the same input a firm may so enlarge its buying as to give it the power to increase its sales."[7] Allen argues that a "diversified firm has a greater volume of purchases to use in enticing potential reciprocity partners to buy from it."[8] Both of these propositions represent necessary but not sufficient conditions for reciprocal dealing. As we noted in Chapter 2, we must distinguish among the number of potential opportunities, the absolute volume of trade affected, and the cost of managing widespread reciprocity in a conglomerate firm. On the last point Dirlam observes, "the more diverse the conglomerate, the more costly the record-keeping necessary to make reciprocity function."[9]

Large, diversified firms, those with the most theoretical potential, are usually characterized by a multidivisional organization structure. Williamson argues that "M-form [multi-divisional] enterprises are less given to reciprocity than are U-form [unitary or functional] firms, _ceteris paribus_. The reason here is that [the] divisionalization concept is corrupted if cross-divisional reciprocity is attempted...As between conglomerates, those that are organized as M-form firms are poorly suited to engage in such practices."[10] Empirically, as we noted in Chapter 4, Markham found that reciprocity as evidenced by a trade relations department, was less likely to be associated with more highly diversified firms and more likely to be associated with firms long established in their traditional lines.[11] On the other hand, using regression analysis, Allen found that "the more five-digit products a company makes, the more opportunities for reciprocity it has and uses."[12] When Allen used the number of contact points or the number of potential reciprocity partners as his measure of reciprocity potential he found them quite highly correlated with the diversification measure, and when the latter was excluded from the equation, "the opportunity variables did not perform well."[13] He concluded that all three measures are correlated with the "ideal" measure of opportunity and correlated with each other. In statistical terms at least, we would agree with Allen that, "we can assess the likelihood that a firm will use reciprocity without looking for specific reciprocity partners or casting a statistical dragnet for contact points. The diversification variable is equally powerful and is much more easily accessible."[14] As we shall see in Chapter 6, the courts (with the exception of the _Ingersoll-Rand_, _Allis-Chalmers v._

White Consolidated, and White Consolidated and White Motor cases) have been unwilling to condemn a conglomerate merger solely because it increases the potential for reciprocity. In Consolidated Foods, Supreme Court Justice Stewart stated, "It obviously requires more than...[the] bare potential for reciprocal buying to bring a merger within the ban of [Section] 7", and "clearly the opportunity for reciprocity is not alone enough to invalidate a merger under [Section] 7."[15]

SUPPLIERS ARE CUSTOMERS

It is obvious that unless the suppliers or potential suppliers of a firm are or can also be its customers, there is no possibility for reciprocity. As Stocking and Mueller point out, "unless they buy goods of the sort made by the firm wishing to practise business reciprocity, suppliers do not lend themselves readily to such arrangements."[16] For this reason, reciprocity is usually practiced with intermediate goods (rather than with final goods and services) exchanged between industrial corporations. Consumer goods sold to individuals (or to the distributors of consumer goods) are out because such retail customers (or distributors) are not significant suppliers to the producer of such products. A minor, and economically insignificant, exception occurs when a firm's employees are also customers, e.g., the automobile manufacturers encourage their employees to buy the car they make.

This requirement that reciprocity mates be both suppliers and customers eliminates many other firms. A firm whose product is sold exclusively to the public or to public institutions will not be able to engage in reciprocal dealing because its suppliers will have no possible use for the product. This point was illustrated in the General Dynamics case:

> While the defendant's [General Dynamics] 1957 purchases from its vendors totalled approximately one-half billion dollars, it was not in a position to convert this huge purchasing power into market power, for the bulk [75 percent to 85 percent] of the corporation's products [military equipment] were sold to the government.[17]

The same point was made in the ITT-Grinnell[18] and ITT-Canteen[19] cases where a significant portion of the market for the defendant's automatic sprinkler systems and food catering services were public institutions such as hospitals and schools. In the General Dynamics case it was argued that Liquid Carbonic, a large producer of $CO_2$ and industrial gases, recognized General Dynamic's unexploited monopsony power, and saw the merger as the means by which it could be directed to increase Liquid Carbonic's sales through reciprocity.[20] The obvious exception to the rule that reciprocal dealing depends on a firm's suppliers or potential suppliers also being its potential customers is the case of

secondary or round-robin reciprocity. Here more than two firms are involved in a chain of mutual input-output relationships. In the Ingersoll-Rand case it was asserted that as a purchaser of steel Ingersoll-Rand could induce its steel suppliers to pressure the mining companies, from which the steel-makers bought coal, to have the mining companies purchase their equipment from Ingersoll-Rand's susidiaries, which manufactured underground coal mining equipment.[21] As we have noted in Chapter 4, three-way reciprocal dealing is certainly not unknown.

HOMOGENEOUS PRODUCT

Reciprocity is facilitated, *ceteris paribus*, when the product that a firm's suppliers are being requested to purchase is homogeneous or at least one for which a large number of close substitutes are available. In other words, the suppliers should be indifferent between buying from the firm requesting reciprocal dealing or buying from its competitors. In both the ITT-Hartford and ITT-Canteen cases the nature of the product was a significant issue in determining the potential for reciprocal dealing resulting from the mergers. Judge Timbers in the ITT-Hartford case quoted the testimony of the FTC's chief economist Willard F. Mueller:

> The product involved [in reciprocal dealing] must be either interchangeable with the product sold by its competitor--in other words be, in the economist's term, more or less homogeneous--or when it is differentiated, then these differences can be translated into price and cost differences.[22]

However, there seems to be some confusion as to exactly what Dr. Mueller's position is on this point. Because, in a later journal article, supposedly based on his testimony in this case, Dr. Mueller said:

> ...There is no requirement that the product sold by a potential reciprocity partner be a "homogeneous" item, one that is perfectly interchangeable with the products of its competitors. In my own studies of the practice, for example, I have found many instances of reciprocity in which the product involved was not, contrary to the argument of many commentators in this area, a homogeneous commodity. In practice, the only case where the "differentiation" created by service or advertising completely precludes reciprocal dealing is where the product of one of the proposed reciprocity partners is so strongly distinguished from those of its competitors as to give it an effective monopoly in its product market....[23]

The confusion arises because the question is one of degree. Judge Timbers seems to conclude that a product cannot be appropriate for reciprocal dealing unless it is almost completely homogeneous for, after quoting Dr. Mueller's testimony, he said,

> If there are significant differences between the insurance coverage offered by Hartford and its competitors, ITT suppliers presumably would be reluctant, and would find it difficult to transfer their insurance business to Hartford.[24]

As we shall point out in our analysis of the ITT-Hartford case in Chapter 6, the judge may have been mistaken in his conclusion that the types of insurances under consideration did not lend themselves to reciprocal dealing.

Citing the testimony of Professor Peter Steiner and the article by Dean Ammer, Judge Austin in the ITT-Canteen case stated:

> It has long been recognized that reciprocal dealing is likely to occur, if at all, in industries where products are homogeneous and the prices charged by competing suppliers are essentially the same...In contrast, reciprocal dealing is much less likely to occur in an industry where price, quality, and service vary significantly among competing suppliers.[25]

He concluded that the food service business in which Canteen was engaged "the variations among food service contractors in price, performance, and service concepts provide well recognized and effective criteria for selecting contractors without regard to reciprocity considerations".[26] But the argument that a complex product (multi-attribute) is not likely to be a candidate for reciprocity can be pushed too far. In both the ITT-Canteen and ITT-Hartford cases it was argued that a product is more likely to be evaluated by elaborate bidding and costing procedures. Assuming such to be the case, it only suggests that differences in the various attributes can be identified and made commensurable. If that is the case then comparisons can be made and the degree of substitutability established.

Looking at the decided case, it is clear that the products involved in actual reciprocity or implicitly deemed appropriate for reciprocal dealing ranged from virtually homogeneous to ones where only reasonably good substitutes were available. For example, in the General Dynamics case the products involved consisted of $CO_2$ and industrial gases where all major suppliers offered virtually identical price, quality, and service terms. In Consolidated Foods, the dehydrated onion and garlic sold by Gentry (Consolidated's subsidiary) was apparently almost

interchangeable with that sold by its major competitor, Basic Vegetable Products. Obviously not homogeneous, but still having a number of fairly close substitutes were (a) the rolling mills involved in the Allis-Chalmers[27] and U.S. v. White Consolidated[28] cases, (b) underground mining equipment in the Ingersoll-Rand case, and (c) transportation services and equipment supplied to railroads in the Northwest Industries[29] case.

## EXCESS CAPACITY

Stocking and Mueller state, "The existence of unused capacity in the short run, although not essential to reciprocal buying, is conducive to it."[30] Since price cuts, particularly in oligopolistic industries, may be followed by rivals, reciprocal buying may be useful in maintaining sales in the face of declining demand. Such sales are made at the expense of rivals unable to use reciprocity in a similar fashion. It is important to note that if a firm is already fully utilizing its monopsony power, it cannot also use it to increase its sales in reciprocal dealing. In this case, market power is simply transferred from one market (inputs) to another (outputs). In the General Dynamics case Judge Canella cites a report written by a Liquid Carbonic executive at the time of the merger in which it states "that the plants of Liquid Carbonic were operating at 65 percent of capacity and production thus could be readily increased for the 'additional sales that will be generated with the assistance of General Dynamics'."[31] He quoted another Liquid Carbonic official as saying:

> ...the advantage of this reciprocity would be of unlimited value in getting a load on our plants both old and new--if through reciprocity, we could put a load on all our plants on a year-round basis, our earnings could rise very rapidly.[32]

In an article published in mid-1960, Sales Management stated that its "investigations disclosed a record number of companies are employing reciprocal selling as a tool for increasing sales, acquiring new customers, expanding share of market."[33] The trade journal gave three reasons for its growing use: an attempt to maintain sales in the recession of 1958, the trend to diversification which provides more opportunities for reciprocal dealing, and "heightened competitive pressures" which "have led many companies to seek markets 'sewn up by reciprocity."[34] The same finding was made by Sloane in his survey published in 1961[35]--see Chapter 4. Dauner, in his 1967 survey, found that excess capacity was the most important reason seen by purchasing agents for why a company practises reciprocity.[36] In periods of excess capacity marginal cost is often well below price, particularly in capital intensive industries; the maintenance of output even at a lower price industry-wide price can be very important. To this extent it should not be surprising to observe

that the chemical, petroleum, and steel industries were heavily engaged in reciprocal dealing.

More recently, quite a different problem arose; how to obtain crucial inputs in the face of shortages in 1973 and 1974. The result was the use of reverse or time reciprocity. Bird describes the latter in terms of what an industrial buyer says to his supplier's salesman:

> My firm has bought from your firm during periods when sales were difficult to make. We took care of you and your firm when you needed our order. Now that your products are scarce, my firm expects you and your firm to take care of us by selling your scarce products to us now. If you will take care of our firm now, we will buy from your firm when the economy again shifts to a buyer's market.[37]

In February 1974, Bird sent 374 questionnaires to members of the Carolinas-Virginia Purchasing Management Association and received 162 replies. He found that 72 percent of the respondents said they were using time reciprocity. Yet 44 percent thought reciprocity in any form in the buying process was unethical and only 43 percent felt reciprocity was legal.[38]

## MARKET POWER, ASYMMETRY OF FIRMS' POSITIONS

Reciprocity, other than coincidental or pure convenience reciprocity and simple horatory reciprocity requires the existence of market power, for it is "the subset of mutual trading that is unexplained by either chance or ordinary cost-quality advantages" that we wish to explain. If all the relevant markets are perfectly competitive, it is obvious that no firm can coerce or induce another to engage in reciprocal dealing unless both firms find it convenient and efficient to do so. Even if the markets are competitive there are costs of acquiring information and selling costs to be borne. As Lorie and Halpern point out, "Two firms both selling and buying in effectively competitive markets, could agree to buy from each other in order to reduce these costs."[39] Ferguson explains, "The fact that reciprocity is often practised by firms without market power is strong evidence that there are legitimate reasons for the practice."[40]

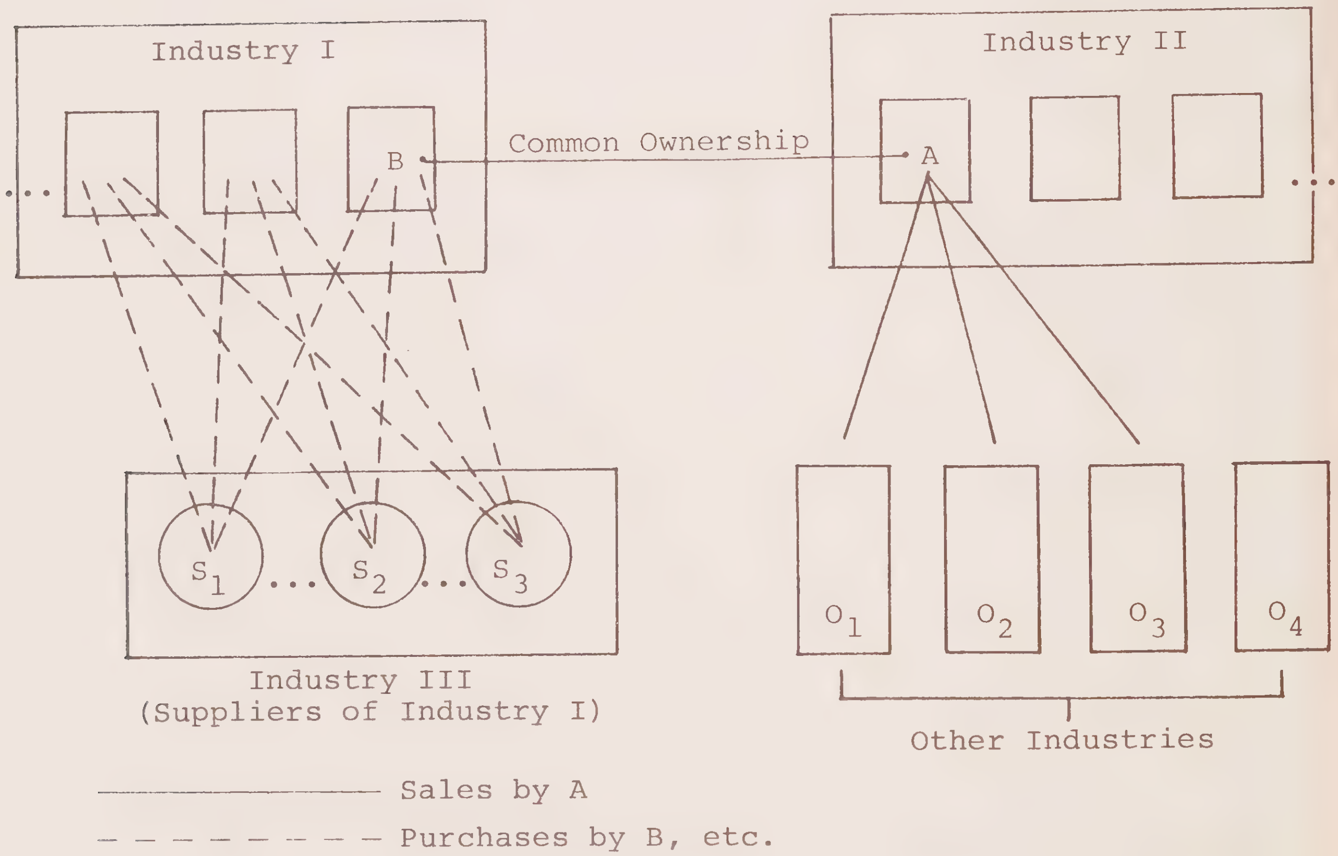
Stocking and Mueller state that the use of reciprocity is invited when an individual firm faces a sloping demand curve and where marginal costs are constant over a wide range of output.[41] By definition, each firm in a perfectly competitive industry faces a horizontal demand curve. The existence of a sloping demand curve for an individual firm implies that the firm operates in an imperfectly competitive market. They argue that

in oligopolistic industries reciprocal buying may be more effective in shifting a firm's demand curve than the use of advertising, particularly if the firm sells a homogeneous product to informed industrial buyers. In other words, reciprocal buying is facilitated by an oligopolistic market structure in the initiating firm's industry.

Reciprocity is a potential public policy concern when one or more firms involved possesses market power. In particular, it is a necessary condition for coercive reciprocity that one of the reciprocity partners have monopsony power--the ability to influence the price and other terms on which it purchases its inputs. It will be useful to refer to Chart 3.

CHART 3

FIRM AND INDUSTRY RELATIONSHIPS IN RECIPROCAL DEALING



Firm A in Industry II sells its products to the firms $S_1$, $S_2$, ... $S_n$, who are suppliers or potential suppliers of the firms in Industry I, Firm B in particular. Firm A may also sell to firms in other industries, e.g., $0_1$, $0_2$, ... $0_n$. Firm B in Industry I purchases one or more of its inputs from $S_1$, $S_2$, etc. Either through acquisition or internal growth both firms A and B are under common ownership. Firm B has monopsony power vis-à-vis $S_1$, $S_2$, ... if it is one of few buyers of these suppliers' products. The strongest position for B appears to occur if it is the only buyer of the output of $S_1$, $S_2$, ... and the number of producers of that output is large. But B's ability to impose higher costs on $S_1$, $S_2$, ... by requiring them to purchase one of their inputs from it affiliate A at above market prices is limited to the extent to which $S_1$, $S_2$, ... are earning a supra-normal return. As Ferguson points out, "If the supplier-seller is earning only a competitive rate of return, then the buyer cannot impose additional costs on him...Only if the suppliers are earning extra-normal income can the buyer hope to gain anything from the practice of reciprocity."[44] It would appear that if B is a true monopsonist he would be better off to use his buying power directly in lowering the price he pays for the inputs supplied by $S_1$, $S_2$, ....[45]

However, B may be constrained from fully utilizing his market power in his input market for a variety of reasons. It is this case, which involves the utilization of otherwise unexploited market power in the form of coercive reciprocity, that represents the most important and difficult public policy problem. The issue of the direct versus indirect use of market power will be explored in more detail below.

In general, the potential for overt reciprocity occurs because of the asymmetry in the positions of the various firms in the industries involved. Stocking and Mueller put it this way, "if all firms in an industry were of the same size, sold identical products, and bought identical inputs, reciprocal buying would give none an advantage over any other."[46] In other words, the demand/offer of reciprocity would be a competitive weapon available to all and a competitive advantage for none. Referring to Chart 3 again, because of their joint ownership, we can think of B and A as a conglomerate (B-A). Following Turner[47] we argue that conditional reciprocity (i.e., coercive and conditional "mutual agreement" types) arises when: (a) B-A is the only firm both selling to $S_1$, $S_2$, ... and buying from them, or if there are other firms who both sell to and buy from $S_1$, $S_2$, ..., B-A must be a leading buyer of the output of $S_1$, $S_2$, .... (b) B-A must buy or be able to buy a sufficient proportion of Industry III's output to be important to $S_1$, $S_2$, .... (c) If B-A is a distributor rather than a user of Industry III's output, it must have a degree of market power in its output market to have leverage over $S_1$, $S_2$, .... (d) Industry III must be imperfectly competitive or there will be no producer surplus for B-A to

attempt to capture; and (e) Purchases by Industry III must account for a substantial share of the total output of Industry II if any significant foreclosure of the market for Industry II's input (produced by Firm A and its competitors) is to take place as a result of B-A's ability to utilize reciprocity.[48] We shall explore a variety of cases below.

Scherer describes the conditions under which a conglomerate firm is able to exert leverage in reciprocal dealings.

> In general, conglomerate leverage is strongest when the giant firm sells only one or a very few narrow segments of its product line to a supplier who in turn is anxious to satisfy the demand for an input employed by all of the conglomerate's divisions. To the extent that this generalization is valid, significant examples of conglomerate leverage are likely to be limited to a small proportion of the typical giant firm's total sales.[49]

Willard Mueller argues that "the amount of a firm's reciprocity 'leverage' is determined by the absolute dollar volume of its purchases from its suppliers versus the potential dollar volume of their purchases from it. Since reciprocity practitioners generally follow a 'balance of payments' concept in their development of these reciprocal arrangements, the initiating firm's dollar volume of purchases, not its market share, is the critical magnitude involved here."[50]

This proposition may be true for firms engaging in convenience or consensual reciprocity, but such conditions are insufficient for the initiating firm to be able to practice coercive reciprocity. Not only must the absolute volume of purchases be fairly large, but also the initiating firm must account for an important fraction of its partner's output. If there are many suppliers, as we have noted, the dominant partner will almost always use its power directly in the input market rather than in the output market to increase its own or its affiliates' sales. Therefore the greatest potential for coercive reciprocity occurs when the dominant firm has monopsony power and its suppliers operate in an imperfectly competitive industry. Referring to Chart 3 we can state that the greatest leverage appears to occur where (a) Firm B-A purchases an absolutely large volume of Industry III's output, (b) where B-A's purchases account for a significant fraction of Industry III's total output, and (c) where Industry III's purchases from B-A are large in absolute volume but not a large proportion of B-A's total sales.[51]

Judicial analysis of overt reciprocity has revolved around the concept of leverage, and the judges have analyzed the concept with varying degrees of sophistication and proficiency. Leverage

was first considered in the early coercive reciprocity cases. In the first of these, the Waugh Equipment Company produced draft gears for sale to railways for use in their freight cars. Waugh itself did not make significant purchases from the railway and thus did not have the leverage necessary to induce the railways to purchase its draft gears rather than those of its competitors except on the basis of price, quality, and service. But Waugh was acquired by executives of Armour & Co. whose business was important to a number of competing railroads. The Federal Trade Commission found that:

> Much of this [railway freight] traffic is competitive as between two and often more railroads, its routing by their respective roads is constantly and insistently sought and the traffic department of Armour & Co. is daily solicited by the traffic departments of one or another of the railroads for business. The influence which they [the executives] agreed to exert was that influence wich had been acquired, and was then, and is now, possessed by them by virtue of the large volume of competitive traffic of Armour & Co. and its subsidiaries, which traffic had been for years and was at the time of the making of this agreement, and is now controlled and directed by respondent, F. W. Ellis [Vice President of Armour in charge of traffic and a Waugh shareholder].[52]

It appears that the Commission felt that Waugh had leverage which gave it the opportunity to engage in coercive reciprocity because Armour's purchases were not only large in an absolute sense, but also proportionately significant and could easily be transferred from one railway to another. It also seems apparent that Armour viewed the railways' services as close substitutes for each other.

The first attempt to quantify the extent of leverage is found in the General Dynamics case. Shortly after the defendant acquired Liquid Carbonic, it started a "special sales program" for those customers of Liquid Carbonic's industrial gases who were also suppliers to General Dynamics. As partial proof of his contention that the object of the program was reciprocal dealing, the judge presented a table comparing purchases from and sales to selected special sales program accounts. Leverage ratios in favor of General Dynamics ranged from a low of 17 to 1 to a high of 740 to 1. Judge Canella reasoned that, "if the figures approach equipoise, the only reciprocity approach possible is one of mutual patronage. However, where the ratio indicates a disproportionate amount of sales relative to purchases a distinct ...[and] a predictable threat to competition is presented."[53] From the point of view of economic analysis no such conclusion can be drawn from simple purchase and sales data. First, the

leverage ratio does not indicate the absolute volume of trade involved. For example the highest ratio involved purchases by GD of $173,924 and sales to the same firm (Ace Electronics) of $235. Suppose Ace's total possible purchases of $CO_2$ amounted to $1,000 per year, the use of GD's purchasing power would hardly be worth the effort. Second, let's look at the $173,924 figure and assume Ace could buy $50,000 worth of $CO_2$ from Liquid Carbonic. GD could hardly pressure Ace if GD's purchases accounted for only 1 or 2 percent of Ace's total sales. GD's purchases have to be fairly large in absolute terms and relatively important to a supplier like Ace and the supplier must be able to absorb a fairly large (in absolute terms) volume of the dominant partner's output for overt reciprocity to be utilized effectively.

Another error in the judiciary's analysis of leverage occurred in the Allis-Chalmers v. White Consolidated case. There it was argued that if White Consolidated's annual purchases of steel mill products ($42 million) were combined with Allis-Chalmers' ($44 million) that the merged firm would buy a far larger amount of steel than any of the competitors of Blaw-Knox (a White Consolidated subsidiary) in the rolling mill market.[54] Suppose Blaw-Knox (as part of the A-C and WC conglomerate) did purchase $86 million in steel products and its several competitors bought only $10 million each. The issue is this: how important is $86 million worth of steel sales to even one of the smaller steel makers? If concentrated on say the tenth largest firm, $86 million might be significant in assisting Blaw-Knox in selling its rolling mill equipment to that firm. But if the A-C and WC conglomerate uses what purchasing power it has in that fashion it surely cannot use it vis-a-vis any other steelmaker. In concentrating its purchases to induce the sale of rolling mill equipment the conglomerate is "putting all its purchasing eggs in one basket" and that is undesirable for other business reasons. It may find such leverage is a double-edged sword.

In the ITT-Canteen case, Judge Austin engages in a more sophisticated discussion of some of the factors which determine whether overt reciprocity or reciprocity effect will occur. He deals with four points in this regard: (a) the extent to which ITT's suppliers are actual or potential purchasers of Canteen's output; (b) the scope of the market represented by ITT for the products sold by ITT suppliers; (c) the size and diversification of other companies to which ITT's suppliers sold their products; and (d) the degree to which the market within which ITT's suppliers operate is competitively structured.[55] While not beyond criticism, as we shall indicate in our discussion of the case in Chapter 6, Judge Austin's analysis of leverage is far superior to that found in any of the other cases.

## SOME BROADER ECONOMIC ISSUES

### CREATION VERSUS TRANSFER OF MARKET POWER

The analysis of reciprocal dealing by lawyers, economists, and businessmen is frequently confused by a failure to recognize that reciprocal dealing is a manifestation of market power and not a source of such power. The following statement by Stocking and Mueller illustrates this point:

> ...It is the power of reciprocal buying to increase a firm's sales that is most significant to industrial structure. A large diversified firm, by integrating its buying and selling, may shift its demand function to the right and thereby grow. Such growth may be at the expense of smaller firms.[56]

Under certain, rather limited, circumstances, it is possible for the practice of reciprocal dealing to be, in time, associated with changes in market structure which permit firms to possess or increase their market power. For example, the FTC Staff Report asserts that reciprocal dealing raises the barriers to entry, "may further increase market concentration...", and "leads to structural changes that are irreversible and feed upon themselves."[57] Therefore the report concludes "conglomerate growth becomes a source and a consequence of power."[58] But reciprocal dealing is only the proximate "cause" of changes in market structure. The root is to be found in the use of market power in the form of reciprocal dealing rather than in some other form.

In the short run, coercive reciprocity is most likely to occur if a firm has monopsony power and exercises that power indirectly.[59] We need to distinguish two cases.

1. A firm has monopsony power, but utilizes 100 percent of that power to reduce the price it pays for its inputs. In this case, in the short run it can drive its input prices to marginal cost (provided marginal cost is above the minimum point on the average variable cost curve). In the long run, the firm with monopsony power can only drive its input prices to the minimum point on its supplier's average total cost curve. Under these circumstances, if the firm with monopsony power wished to induce one of its suppliers to engage in reciprocal dealing it would have to forgo a part of the direct use of such power in order to transfer it to its output market and thereby increase its sales to its suppliers or increase the price received from the current level of sales.[60] In other words, if the firm with monopsony power is already exercising it fully "it cannot have it both ways", i.e., directly in its input market and indirectly in its output market. Anderson puts it this way, "If a monopsonist has reached

[his] profit maximizing point, he will have no incentive to promote reciprocal dealing. For reciprocal dealing, by imposing extra costs on suppliers, has the same effect as a demand for a lower price by the monopsonist acting solely as a buyer....Thus reciprocity cannot be used to lever or create new market power because its use reduces the profitability of monopsony power which already exists...this 'transfer of power' is just that--a loss in one market for a gain in another."[61]

In general, proponents of the Chicago school are oblivious to the possibility that the firm could achieve a net benefit merely from the transfer of its market power. Dirlam is not, for he says,

> The view that the use of reciprocity is irrational overlooks the fact that businessmen may prefer to reduce the intensity of competition in their selling markets at the expense of sacrificing competition in their buying markets, perhaps because risks of loss of revenue are weighted more heavily than risks of paying higher prices for available supplies. The outcome is to reduce opportunities for smaller or new competitors.[62]

2. In the second case, firm A has monopsony power but it is less than fully utilized. This could be true for a variety of reasons: the firms from whom it buys are in a regulated industry and have to abide by the authorized tariffs, or firm B's main supplier produces a homogeneous good in an oligopolistic industry and is fearful that cutting the price to B will destroy the common posted price, etc. (these reasons and their implications will be discussed below). Reciprocal dealing may offer a way to utilize otherwise unexploited market power. Again, reciprocity does not create market power, it merely becomes the means by which it is manifested. It is this second case that is the most difficult to deal with, for by merger or expansion into other markets, a firm with monopsony power, but which was at least partially blocked from using that power, is now able to exercise it. As we shall see, it is not obvious, as the Chicago school economists would have us believe, that the effect of using the power to engage in reciprocal dealing is always beneficial, i.e., pro-competitive. This second case is ignored by a number of analysts. Anderson, recognizing only the first case where reciprocal buying is a manifestation of a transfer of fully utilized market power from one market to another, states, "reciprocal dealing, then, would seem to be impossible for firms without market power and unprofitable for firms with market power."[63] Director and Levi elaborate the Chicago view on vertical restraints: "Firms which have some monopoly power over prices and output can impose coercive restrictions on suppliers and customers In the normal case, however, they will lose

revenue if they do impose such restrictions, and this casts some doubt on how prevalent or continued the practice would be. Such firms would lose revenue because they cannot both obtain the advantage of the original power and impose additional coercive restrictions so as to increase their monopoly power."[64] The same point is made more directly in the Report of the Task Force on Productivity and Competition, clearly reflecting the views of Stigler, Coase, and Bowman, that "monopoly power in one commodity is not effectively exploited by manipulating the price of an unrelated one."[65] These statements are correct only in our first case and incorrect in our second.

As early as 1963, without elaborating, Joel Dean pointed out:

> Reciprocity doesn't add anything to market power. It is just a way to exercise it. Reciprocity can do significant social harm only if all alternative ways of exercising the market power are blocked or if capitalizing on the pre-existing market power through reciprocity is in some ways more injurious to society than using it in other ways.[66]

This brings us to the next issue, the implications of the direct versus the indirect use of market power.

## DIRECT VERSUS INDIRECT USE OF MONOPSONY POWER

As we have seen, a degree of monopsony power is necessary for a firm to practice coercive reciprocity. In general, only coercive reciprocity can result in anticompetitive effects. But what is not clear, ex ante, is whether a large diversified firm with monopsony power would improve its net economic position more by using its power directly to reduce the costs of its inputs or use it indirectly through reciprocal dealing to increase the net revenue from its sales. In summary, our argument is that where the monopsonist is unconstrained in the exercise of his power he will use it directly to lower his input costs; where the full use of the market power is inhibited or absolutely constrained the large diversified firm may well use reciprocal dealing to improve its economic position. In the real world there are good reasons why the monopsonist's freedom of action is actually constrained, and the indirect use of market power may be more significant. Finally, we will argue that the indirect use of market power in the form of reciprocal dealing is not always socially desirable (pro-competitive) in its effect.

Roger D. Blair holds the view that the conflict between Mueller, the FTC Staff Report, and Stigler, Ferguson et al. boils down to an empirical question. It is: to what extent do firms which initiate reciprocal dealings have unexploited monopsony power which can effectively be utilized through reciprocity?[67]

Direct Use

The most obvious advantage of using monopsony power directly in an unconstrained environment is that it is simpler than engaging in reciprocity to use that power indirectly. If the many suppliers of an input are earning supra-normal returns and if a firm has monopsony power it can bargain down the price it pays until the suppliers earn only normal profits and utilize the most technically efficient production process.

As to whether a firm with monopsony power will use it directly or indirectly depends on some basic arithmetic to determine the comparative contribution to profits of lowering input costs as compared with increasing sales. Using Steiner's formulation[68] we note that the direct use of purchasing power is preferred if

$$dP > \Pi S$$

where:

$d$ = additional discount on purchases available from use of unexploited monopsony power

$\Pi$ = rate of profit before tax on additional sales

$P$ = dollar volume of purchases from the supplier under consideration

$S$ = dollar volume of additional sales to the supplier under consideration

Using data from the General Dynamics case, Steiner indicates that GD made purchases of $10 million annually from Raytheon while its Liquid Carbonic subsidiary sold $250,000 worth of $CO_2$ to Raytheon. Suppose $\Pi$ = 25 percent (a high figure) and that LC's sales to Raytheon can be doubled. Then the contribution to profit from reciprocity is $62,500. "But this amounts to only 5/8 of a percent of the total dollar volume of its purchases from Raytheon." Steiner continues, "Even a 1 percent decrease in the price of the supplies it purchased from Raytheon would be more profitable to General Dynamics than a reciprocal requirement."[69] While Judge Canella in the General Dynamics case may not have recognized the direct use of monopsony power, Judge Austin in the ITT-Canteen case clearly did. He cites testimony by ITT's president that each purchasing agent was responsible for lowering his costs by 3 to 6 percent per year. Since such purchases amounted to 20 to 25 percent of the average manufacturing operations sales, "the effect of losing a saving on purchases of around 5 percent would amount to about 1 percent of the usual 8 to 10 percent pre-tax profit on sales."[70] ITT's president argued that the net effect of reciprocity on profits would be adverse because the tangible and intangible costs in purchasing would be more than any profits derived from the resulting sales.[71] In testifying for ITT, and in his book, Professor Steiner argues "high leverage (which brings power) makes it relatively attractive to seek a direct discount.

Where leverage is low, reciprocity may pay, but here monopsony power is likely also to be low."[72] But as we have noted above, leverage ratios must be modified by an examination of both the absolute size of the potential increase in sales to suppliers and by the relative importance of the monopsonist's purchases to the supplier.

Conducting a systematic reciprocity program is not without cost. More importantly the comparative transactions cost of conducting a systematic coercive reciprocity program would appear to be greater than bargaining directly with suppliers to lower the monopsonist's input costs. The practical application of systematic reciprocity requires two main elements: (a) the collection of purchasing and sales data to disclose the identity and volume of trade for each supplier (or potential supplier) who is also a customer, (b) contacts by senior executives of the initiating firm (to utilize this information) with their counterparts in the firm with which they wish to engage in reciprocal dealing. It is important to note that neither of these functions would be carried out in the typical firm. Normally purchasing and sales are separate functions under the control of different executives and each pursues its own objectives. The conduct of a systematic reciprocity program requires information not usually collected, and either the creation of a new unit in the organization (i.e., a trade relations department[73]) or the performance of the function by senior executives. High level contacts are necessary to override the normal proclivities of the supplier's purchasing department. The purchasing agent is unable "to see the big picture" until given directions by his superior. The sales department of the firm with monopsony power might similarly be unaware of such power or that it might be used to increase sales.

Some evidence of the information costs and organizational effort required to use monopsony power indirectly via reciprocity came out in the General Dynamics case. Vendor books were prepared from information supplied by the various divisions of GD. These listed 4,000 suppliers and subcontractors whose 1958 sales to GD exceeded $10,000. A copy was provided to each regional sales manager of Liquid Carbonic for use in the Special Sales Program. Later a list of some 350 companies, each of which sold GD a minimum of $250,000 in 1960, was compiled in a "National Accounts System". Each of these firms had multi-plant locations which transcended the boundaries of Liquid Carbonic's sales regions. Contacts by top level GD executives, on behalf of Liquid Carbonic, were concentrated on suppliers "operating under a headquarters-controlled purchasing mandate...."[74]

It was feared that pressure applied directly to local purchasing agents could lead to complaints to the antitrust authorities. Perhaps the reason GD expended so much effort on its systematic reciprocity program is because it was blocked

from using its purchasing power directly. Like Ferguson, we conclude that "only if [a monopsonist] is constrained not to use his purchasing power directly will he resort to reciprocity."[75]

Indirect Use

The indirect use of monopsony power through induced reciprocal dealing becomes attractive when a firm is blocked or constrained in some degree from fully utilizing it in its input market. A careful analysis of the effects of reciprocal dealing under these general circumstances requires that we identify a number of cases:

1. Regulated Industry. Referring to Chart 3, let us assume firm B has unexploited monopsony power vis-a-vis $S_1$, $S_2$, ... in Industry III and that Industry III is a regulated industry, e.g., a public utility or common carrier. The assumptions fit the facts in the Waugh Equipment[76] and Mechanical Manufacturing[77] cases. In the former B is Armour, a large meatpacker and railroad shipper, and $S_1$, $S_2$, ... are railroads regulated by the ICC. Since the railroads can't give Armour lower rates than those established by the ICC, Armour is apparently frustrated in its ability to use its large purchasing power as a shipper directly. So Armour acquires Waugh (firm A in Chart 3) which manufactures a piece of equipment used by all railroads. Professor Miller continues the story:

> Incentives exist for both firm [B] and firm[s $S_1$, $S_2$, ...] to evade rate regulation, and reciprocity provides a mechanism. By purchasing increased output from A (at an inflated or monopoly price), firms[s $S_1$, $S_2$, ... ] can produce the effect of a price cut in its sales to [B] without seeming to violate the price established by regulation. Reciprocity is substituted for an otherwise blatantly illegal price cut.[78]

This arrangement is usually praised. For example, Anderson likens minimum rate rules to those set by a private cartel and "their evasion will in most cases promote those same policies which the antitrust laws are designed to promote."[79]

He continues, "Movement away from prices inflated by cartels...obviously involves a movement toward the desired competitive solution and should not be prohibited."[80] For this argument to be correct we must assume that the ICC's rates involved price discrimination adverse to large shippers like Armour. In other words, the rates applicable to Armour reflected a higher percentage above marginal cost that the rates to other shippers. Economically, such price discrimination is unjustifiable and the allocation of resources would appear to be improved (i.e., there is both a social and a private benefit) if it is evaded.

However, if the ICC had set each rate on the basis of a constant proportional markup above marginal cost,[81] the use by Armour of its monopsony power to get an indirect rate reduction would result in a pecuniary gain to Armour and perhaps a loss to society. This occurs, because, ceteris paribus, Armour will be consuming too much railway service at the lower effective rate and other shippers, whose rates will have to be raised to cover total costs, will be consuming too little.[82] In fact, in either case it is extremely difficult to determine the net effect on output. We need to know the relative elasticities of demand for the various purchases and the relative size of the amounts purchased by each. To the extent that reciprocity, in this case via indirect price cuts, assists in moving price and output toward the competitive position a social gain occurs.

Before leaving the case of the regulated industry it may be useful to deal with Ferguson's treatment of it. He focuses on the railroads as buyers of railroad equipment. He argues that they pay higher prices for certain of their equipment than they otherwise would "in order to grant rebates to the larger shippers or buyers of railroad services, who are also in this case sellers of railroad equipment."[83] So far so good, but here he begins to claim too much when he says, "The large buyers of railroad services are...not coercing the railroads to buy from their equipment firm. As other equipment manufacturers were available, it is obvious that the railroads voluntarily entered the agreement to secure business that might otherwise have gone to other types of transport."[84]

He concludes that a firm with market power in the output market conbined with restrictions on price cutting "use reciprocity as a means of selling at a discount."[85] Clearly Professor Ferguson didn't understand the facts in the Waugh Equipment case. There the initiative for reciprocity came from Armour, whose executives recognized its monopsony power. The railroads most reluncantly purchased equipment from Waugh. In terms of market structure there were eight manufacturers of draft gears and that market was at least moderately concentrated. Viewed nationally, there were a large number of railroads in the late 1920's, and the four largest could not have account for one-quarter of all equipment purchases. Finally, at the time the reciprocity took place truck transport was in its infancy as a competitor with the railroads. If what Ferguson argues is true, one would expect the railroads to approach Armour to inquire how they could give Armour a rebate on its shipments without violating the ICC regulations. This did not occur. Ferguson's conclusion that "no rationale has been developed to support coercive reciprocity (in which the buyer forces suppliers to purchase goods from him at prices above those available from other sources) when there are one or a few buyers and many sellers", is not supportable.[86] If he had only recognized that the buyer with

market power in the *Waugh* case was Armour and that it was its suppliers (the railroads) who were constrained in the prices at which they sold to Armour, and that it was Armour who initiated the reciprocity to benefit from its monopsony power, Ferguson could not have reached the incorrect conclusions he did.

2. *Oligopolistic Interdependence*. We shall first examine the implications of the situation where firm B in Industry I has unexploited monopsony power vis-a-vis its suppliers $S_1$, $S_2$, ... in Industry III, and Industry III is an oligopoly, for simplicity, selling a homogeneous good. Let us further assume that $S_1$, $S_2$, ... not only recognize their interdependence, but are able to act upon it and have established an industry price which permits them to earn supra-competitive profits.

While $S_1$, for example, might not agree to cut the price of the product it sells to B, fearing that its competitors will match the price, oligopolistic coordination will break down, and all firms will be worse off selling at a lower price, he may well agree to purchase from A, a subsidiary of B. By consuming more of A's product or by paying a higher price for A's product, $S_1$ is granting B a secret price cut. As Miller puts it, "the appearance of upholding the oligopoly or cartel price can be maintained, and at the same time the price may be secretly cut, if [$S_1$] engages in reciprocity." It is usually argued that such reciprocal dealing is beneficial since it facilitates tacit price-cutting even if it does so by means of implicit price discrimination. Keeshan states, "where the price cut is made by an oligopolist to increase his market share, reciprocity results in a more competitive price, for the oligopolist's supra-competitive profit margin has been reduced as his price moves toward marginal cost. Here the impact of reciprocity on output will depend on whether a lower price would have been set without price discrimination. This will in turn depend on the number of customers in various price ranges and the differences in their demand elasticities."[88]

While apparently facilitating price shading, Blake argues that reciprocal buying enables the oligopolist to win additional sales "without threatening the oligopoly price structure. But for this device, list prices would tend to be lower and would be subject to more direct erosion until a reduction was achieved."[89]

Mueller agrees, stating that reciprocity changes "the mechanics of the competitive process by dampening rivalry based on price quality and service. It compounds and further rigidifies the already inflexible 'administered' prices of oligopolistic markets...."[90]

Blake's and Mueller's arguments are not persuasive. In the absence of reciprocity it is unlikely that other forces will change the coordinated behavior of the members of a tight oligopoly. Furthermore, reciprocity is more difficult to detect

than many forms of non-price competition. The price structure will probably not fall in the face of reciprocity. We agree with Keeshan's observations that "even if reciprocity makes industry-wide price reductions less probable by offering the firm an alternative to open price cuts, it nonetheless increases the probability that average prices will be closer to marginal cost. Given the lower risks associated with price cuts made through reciprocity, the probability of lower average prices from this use of reciprocity would outweigh any likely decrease in the probability of open price reductions."[91]

In his testimony before the Royal Commission on Corporate Concentration, Professor Caves described "reciprocity as a form of price discrimination in the sense that the firm pressing reciprocity on its market partner is basically making an all-or-nothing offer...Either you buy from me or you lose my business!"[92]

He recognized both advantages and disadvantages to reciprocal dealing. "The advantage it may sometimes have, especially when it is sporadic rather than on-going and systematic, is that it can break up a price-fixing conspiracy."[93]

He notes that firms are vulnerable when they have been selling at prices well above their cost of production.[94] The second case, in terms of Chart 3 on page 68, involves oligopoly in Industry II where Firm A wishes to expand its market share without recourse overt price cutting. If Firm A is part of the conglomerate (B-A) it can use reciprocal dealing arrangements to increase its sales to $S_1$, $S_2$, ... who are suppliers to B. This is the case emphasized by Leibeler in his analysis of the Consolidated Foods case. He noted that in the garlic market (Industry II in Chart 3) Gentry (Firm A, owned by Consolidated Foods or Firm B) and Basic, its major competitor accounted for 90 percent of total sales. Leibeler also points out that "open price competition is severely inhibited because any initial price cut by either major firm would immediately be matched by the other and would have to be given to all buyers."[95] Reciprocal dealing provides a way for Gentry to practice price discrimination and increase its net revenues and market share. Ignoring any monopsony power that it might have, Consolidated can increase Gentry's sales by paying slightly more for its pickles (made by $S_1$, $S_2$, ...) provided they agree to purchase their garlic from Gentry. To combat Gentry's increasing market share, Leibeler argues Basic could lower its price, find a merger partner like Consolidated and offer reciprocal deals or buy pickles at higher prices and sell them off at a loss.[96] He concludes that, "Far from reinforcing an oligopolistic market structure, as the Court and the FTC claimed it would, reciprocity in this case could well, indeed most likely would, disrupt the ologopolistic price structure and greatly increase competition in the garlic industry."[97] As evidence of the increased competition he says, "it appears that after Consolidated-Gentry began to engage in reciprocal dealing, Basic

opened more warehouses, added to its sales force, improved services to its customers and added new products to its line. It also restructured its price schedules to introduce more flexibility, specifically to meet the increased competition from Gentry."[98]

A related instance in which reciprocity can be used to increase competitive pressures in an oligopoly occurs when a firm (i.e., B in Chart 3) seeks entry into another industry, i.e., it establishes a new Firm A in Industry II. Potential reactions by A's competitors could range from "warfare" (all lower their prices) to a "join the club" accommodation (increase price and restructure their output to give A a share). Firm B could give its subsidiary "a leg up" if it is able to encourage its suppliers $S_1$, $S_2$, ... to purchase from A in return for continued purchases from them. By facilitating new entry at a reasonable scale reciprocal dealing is a pro-competitive force in Industry II.[99]

3. Fear of Antitrust Action. The possibility of even unwarranted action by the antitrust authorities may inhibit a firm with monopsony power from using it fully vis-a-vis its suppliers. In U.S. v. Griffith the Supreme Court held that:

> Large-scale buying is not, of course, unlawful per se. It may yield price or other lawful advantages to the buyer. It may not, however, be used to monopolize or to attempt to monopolize interstate trade or commerce. Nor...may it be used to stifle competition by denying competitors less favorably situated access to the market.[100]

When one recognizes that at least a minor theme in U.S. antitrust cases relates more to the protection of competitors than to the encouragement of competition, and the fact that antitrust investigations stem largely from the complaints of trade buyers or sellers, it is not surprising that firms with monopsony power do not feel they can fully exploit it directly. Anderson notes that the Robinson-Patman Act, "may result in artificial price restraints because mere differences in price are considered prima facie evidence of illegal price discrimination. Although this presumption may be rebutted by proof of a cost justification, such a showing may be difficult and expensive to make."[101] Therefore, the suppliers of firm B($S_1$, $S_2$, ...) sell to everyone at the same price or by means of a very simple price/quantity formula. But they are willing to engage in reciprocity, in recognition of B's unexploited monopsony power, by buying from A who is affiliated with B.

Anderson raises a related case. Reciprocity may enable a firm with monopsony power to exploit it more fully through price discrimination since reciprocal dealing elminates the threat of arbitrage by suppliers.[102] Through reciprocal dealing, the monopsonist can discriminate in his purchases, reflecting the

fact that different suppliers have different elasticities of supply. In its most extreme form the monopsonist practices perfect price discrimination when he makes his supplier an all-or-nothing offer of purchases from the supplier combined with sales to the supplier. Such a technique avoids the constraints of the Robinson-Patman Act and maximizes the return to the firm with monopsony power.

To the extent that such indirect price shading results in cost-justified price cuts, average price in the industry is reduced. If net output is increased toward the competitive level then there is a social gain from reciprocity.

4. When Purchasers Are Not Suppliers or When Suppliers Are Not Purchasers. A firm with monopsony power may not be able to exploit that power because the purchasers of its output are not also suppliers or because it suppliers are not also purchasers of its output. The Waugh Equipment case is an example of the latter situation. Before it acquired Waugh Equipment,Armour, who possessed significant unexploited monopsony power vis-a-vis the railroads, had nothing to sell them in return. With Waugh as part of the family (although it was owned by executives of Armour) Armour could receive effectively lower rail shipping rates by selling draft gears, made by Waugh, to the railroads vying for its business. By this means, Waugh's market share increased from 1 percent to 35 percent in the six years the scheme was in operation.[103] We might point out that if a firm, like Armour, really has coercive monopsony power it need not produce the product its affiliate sells to his suppliers. It could simply buy from other manufacturers and resell to its suppliers at an appropriate markup. In that way it could avoid the charge, as was the case with Waugh Equipment, that the product was of inferior quality.[104]

The former case could occur when a large firm with monopsony power sells all its output to firms or entities who are not in a position to act as suppliers to the firm under consideration. The General Dynamics and ITT-Grinnell cases illustrate this situation. In 1957 General Dynamics purchases from its suppliers amounted to over $500 million, but over three-quarters of its output was sold to agencies of the U.S. Government. Judge Canella concluded that Liquid Carbonic considered the opportunities for reciprocal dealing aided by General Dynamic's purchasing power to be the most significant advantage to be derived from the merger. He saw GD as primarily motivated by the opportunity for diversification as that firm was seeking to reduce its sales to the government to 50 percent of its total sales.[105] But he found that "General Dynamics was not ignorant of the reciprocity considerations entertained by Liquid Carbonic."[106] After the merger GD estimated that "at least 75 percent of our suppliers purchase, to some extent, the types of products or equipment offered for sale by the Liquid Carbonic Division."[107]

In the ITT-Grinnell case ITT argued that it was not able to assist Grinnell through reciprocity because those responsible for the purchase of automatic sprinklers (20 percent of Grinnell's total sales of $341 million in 1968) were not suppliers of ITT. They said that 30 percent of such sales were to educational institutions, hospitals, and retail establishments and 80 percent of the remainder were sold as part of new construction on the basis of bids submitted by general or mechanical contractors who were not significant suppliers to ITT.[108] Judge Timbers thought that the increasing proportion of sprinkler business awarded on the basis of competitive bidding minimized the potential use of reciprocity.[109]

5. Government Constrained Profit Rate. A firm with monopsony power may have no incentive to utilize that power directly if it is unable to reap the benefits in terms of higher profits if the rate of return is constrained by government regulation. Reciprocal buying can provide a vehicle whereby the benefits of monopsony power are transferred from a firm in which profits are constrained to one where they are not. The situation is analogous to the case of a regulated communications utility. The regulated firm creates an unregulated subsidiary to act as a major supplier of equipment. By paying high prices for its equipment the regulated firm (which operates on a cost-plus basis) is able to transfer part of its monopoly power to its subsidiary or affiliated firm (i.e., both may be owned by a common parent) which is able to earn excess profits. By inflating its equipment, costs the regulated firm is able to increase total profits while keeping its rate of return within the regulatory commission's maximum.[110]

Blackstone asserts that reciprocal buying "is particularly well suited to the defense sector where firms must maximize profits subject to profit constraint. Reciprocal buying provides firms with an opportunity to conceal their defense profits..."[111] He points out that a RAND study indicated that for all defense contractors during 1947-1964 an average of 48 percent of contract revenues went to subcontractors. Among the large aerospace firms, such as General Dynamics, the percentage was 52 percent to 62 percent.[112] "Another significant characteristic of the defense industry is the fact that most firms are highly diversified, producing products in many industries other than defense."[113]

Because defense contracting is highly concentrated, particularly at the level of specific products, and because of the extent of subcontracting, defense contractors have considerable monopsony power. "The ability to conceal defense profits is very important, first, because the procurement authorities emphasize reducing defense profits [often ignoring the level of total cost], and second, because excessive defense profits might induce much more extensive regulation than occurs under the present contract system."[114] Blackstone provides some

illustrative quantitative examples which show that reciprocity by defense contractors such as General Dynamics might well result in higher profits than the receipt of direct price concessions from supplier/subcontractors.[115]

6. Reciprocity as an Alternative to Predatory Price-Cutting by Conglomerate Firms. Steiner argues that "predatory reciprocity is a good deal less improbable (*a priori*) than predatory pricing" by large diversified firms.[116] This is a variant on the "deep pocket" theory of selected predatory pricing (even to the point of incurring losses) in some markets while engaging in cross-subsidization to permit the firm as a whole to earn normal profits. As we have done, Steiner points out that it may pay the firm, if it has monopsony power unutilizable in its input market, to shift it to its output market(s). The important point here is that in the typical case of predatory pricing financed by cross-subsidization the firm is simply transfering its market power from one place to another while reciprocity may offer an outlet for otherwise unused market power.

He notes that "the same degree of market power may be more effective in one market than another because the barrier to future entry is greater."[117] Alternatively, where there are different types and degrees of market imperfections, the same expenditure in one market may yield quicker and richer results than in another. Steiner argues, contrary to the Chicago school, "that investment in cross-subsidization is likely to be unwarranted, is not a logical conclusion."[118] For example, if through the aggressive use of reciprocity rivals could be quickly driven out or have their market shares sharply reduced, but entry or re-entry was slow even in the light of excess profits, the return to cross-subsidization would exceed that from buying out rivals.[119] Besides, the Chicago alternative of buying up rivals would almost certainly result in an antitrust prosecution under Section 7 of the Clayton Act. Finally, Steiner is not persuaded to the "available alternative" doctrine in which rational adversaries recognize that both loss as a result of predatory practices and hence strike a bargain (e.g., merger, market sharing arrangement) in which both are better off than they would be in the "warfare" situation. He argues that "it seems to apply *a fortiori* to wars, strikes, and other observable phenomena; phenomena that can be understood as rational in terms of the abasence of acceptable agreement mechanisms, varying perceptions, and the role of threat reinforcement to keep threats credible."[120]

The central issue here is an empirical one. It is that the set of conditions in which the aggressive use of reciprocity as a manifestation of otherwise unused monopsony power is economically attractive is relatively more common than those in which simple predatory pricing is attractive.

## FORECLOSURE, BARRIERS TO ENTRY, AND INCREASED CONCENTRATION

Both the courts and economists have been concerned as to the extent to which (and under what circumstances) reciprocal dealing forecloses a portion of the market to competitors of the firm engaging in reciprocity and whether reciprocal dealing results in a significant barrier to entry. Bruce Allen puts the issue this way--"ultimately, the case against reciprocity and its alleged foreclosure rests on the inability of the initiator's rivals to retaliate or of its partners to resist the attractions of extra business or the threat of its withdrawal."[121]

In the Consolidated Foods case, Supreme Court Justice Douglas quoted with approval the following conclusion of the Federal Trade Commission:

> If reciprocal buying creates for Gentry a protected market, which others cannot penetrate despite superiority of price, quality, or service, competition is lessened whether or not Gentry can expand its market share.[122]

The essence of the foreclosure argument is that the competitors of the firm practicing reciprocity, being "less favourably situated", are unable to compete effectively for the business represented by the suppliers of the firm engaged in reciprocity or its affiliates. Mueller expands on the barriers to entry argument.

> In the extreme case, potential entrants would find much of the market completely "tied up" by existing firms, thus requiring the would-be newcomers to attempt comparable conglomeration in order to compete on equal terms with existing firms. This, in effect, requires the new entrant to enter not only the immediate market it had in mind but many other markets as well and thus to hurdle the capital, technological, and other barriers to entry of not one product market but the whole *series* of markets (industries) that define the activities of this group of reciprocity partners. A truly *unique* barrier to entry is thus created by reciprocity....[123]

Mueller indicates that two of anticompetitive effects of reciprocity are that "it increases market concentration, thereby injuring long-run industrial structure" and that "it encourages cumulative structural changes in the economy, thereby leading to an increase in the centralization of manufacturing resources and

thus to a centralization of decision-making in the hands of the managers of a relatively few industrial firms."[124] The former occurs because, argues Mueller, reciprocity gives the advantaged firms the power to increase the demand for their own products at the expense of rivals.[125] The latter occurs because firm growth through diversification increases the opportunities for reciprocity and so "conglomerate growth becomes both a source and a consequence of market power."[126] Competitors "frozen out" by reciprocal dealing seek merger partners capable of providing opportunities to engage in reciprocity and aggregate concentration increases.[127] In short, Mueller argues that reciprocity results in increased concentration in individual markets and at the macro level.

On all of these points, Mueller almost certainly overstates the case. Again we should avoid generalizations and examine the possibility of foreclosure and the creation of barriers to entry under a variety of circumstances.

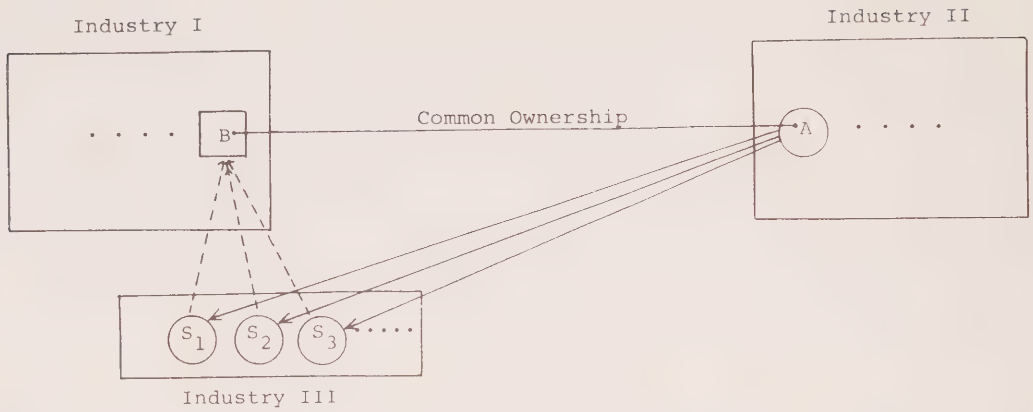
Regrettably, discussions as to the impact of reciprocity on competition concentration and barriers to entry are either imprecise (characterized by a failture to specify the market structure of all the relevant markets) or consider only a few cases. To overcome these difficulties we have set out in Chart 4 (page 88 ) some 27 cases based on the three types of market structure in each of the buying side of Industry I, the selling side of Industry II, and the selling side of Industry III (whose products are bought by Industry I and perhaps other industries). Firm B in Industry I and Firm A in Industry II are under common ownership. While the imperfectly competitive markets are the most interesting, we shall review all the cases set out in Chart 4.

Cases 1, 2, 3 are similar in terms of any impact reciprocity will have on Industry II or Industry III. Neither monopoly or monopsony power is present in the market for Industry III's output, hence neither side can influence A's position in Industry II except to a trivial extent. Any reciprocal dealing will be of the conincidental or convenience type, and to the extent such arrangements exist society is better off since both sides may save on buying/selling costs. Since each firm has only a very small fraction of the market involved, their agreement to trade reciprocally "ties up" only a tiny portion of the market. Any foreclosure is de minimus. Since all firms face similar costs of acquiring information and similar purchasing and selling costs, any new entrant can offer/use reciprocal dealing on the same terms as any existing firm. Reciprocity ties do not constitute a barrier to entry. Ferguson summarizes:

> In the absence of market power, reciprocity, at best can secure sales for the firm at equal prices.

## CHART 4

### MARKET STRUCTURE AND RECIPROCITY




### Possible Market Structures

| Case | I as Buyers of Industry III's Output | III Seller Market Structure | II Seller Market Structure |
|---|---|---|---|
| 1 | PC | PC | PC |
| 2 | PC | PC | O |
| 3 | PC | PC | M |
| 4 | PC | O | PC |
| 5 | PC | O | O |
| 6 | PC | O | M |
| 7 | PC | M | PC |
| 8 | PC | M | O |
| 9 | PC | M | M |
| 10 | $O_s$ | PC | PC |
| 11 | $O_s$ | PC | O |
| 12 | $O_s$ | PC | M |
| 13 | $O_s$ | O | PC |

| Case | I as Buyers of Industry III's Output | III Seller Market Structure | II Seller Market Structure |
|---|---|---|---|
| 14 | $O_s$ | O | O |
| 15 | $O_s$ | O | M |
| 16 | $O_s$ | M | PC |
| 17 | O | M | O |
| 18 | $O_s$ | M | M |
| 19 | $M_s$ | PC | PC |
| 20 | $M_s$ | PC | O |
| 21 | $M_s$ | PC | M |
| 22 | $M_s$ | O | PC |
| 23 | $M_s$ | O | O |
| 24 | $M_s$ | O | M |
| 25 | $M_s$ | M | PC |
| 26 | $M_s$ | M | O |
| 27 | $M_s$ | M | M |

PC = Perfect competition; on the buying side, many buyers, each with an insignificant percent of Industry II's total output; on the selling side, many sellers each producing a tiny percent of industry output.

O = Oligopoly, few sellers.

$M_s$ = Monopsony, single buyer.

M = Monopoly, single seller.

$O_s$ = Oligopsony, few buyers.

> Competitors are foreclosed from sales at equal prices, but this fact is of little consequence since all firms can practice reciprocity; there will be many such agreements among mutual suppliers.[128]

When there are many sellers on both sides of the market (in the simple two-industry case) Finney points out that, "foreclosure cannot amount to more than the foreclosure any buyer's preferences produces." [129]

Note that in Case 3, A already has a monopoly in Industry II and is presumably maximizing profits independently of the existence of reciprocity. To the extent that B-A practices reciprocity with $S_1$, $S_2$, ..., A's market share can be increased only minutely and only to the extent that no additional costs are imposed on $S_1$, $S_2$, ....

Not everyone agrees with this analysis. Denneberg and Cummins claim (referring to the ITT-Hartford case) that ITT's suppliers "would probably be willing to purchase [insurance] from ITT [Hartford] at competitive rates out of loyalty to ITT as one of its customers regardless of the fact that the market [for the goods they supply to ITT] is characterized by perfect competition on both demand and supply sides."[130] In a footnote they state that "for this type of customer loyalty to arise ITT's order must account for a significant portion of the sales [of its supplier]. Such a requirement is not inconsistent with the assumptions of pure competition. This type of reciprocity nearly always has an economic motivation, e.g., finding another buyer to replace ITT may involve added costs. Also it may be worthwhile to the seller to have a guaranteed outlet for a large fraction of its output."[131] The result of this situation, they argue, is that Hartford is able to expand its market at the expense of sellers of insurance who are not buyers of the output Y sold by ITT's suppliers.[132] "Thus, Hartford might be able to gain ground in the insurance market solely because of its connection with a large conglomerate possessing substantial purchasing power in other markets."[133]

Clearly Denenberg and Cummin's last statement (re "substantial purchasing power") is inconsistent with their previous statement that there was perfect competition on both the demand and supply side of the market for Y, the good sold to ITT. But the real question is how much of the market for insurance among the producers of Y can Hartford obtain. Given that both the demand and supply sides of the market for Y are perfectly competitive, Hartford could acquire all the insurance business of ITT's suppliers of Y and still have only a minute fraction of all insurance sales to the Y industry since, by definition, ITT purchases only a tiny fraction of the total output of Y (even though it may take a high proportion of one producer's output). What is more, any other insurance firm who slightly undercuts

Hartford will get ITT's supplier's business since the transactions cost referred to by Denenberg and Cummins are low and similar for all firms in a perfectly competitive market. In the context they specify, buyer/seller loyalty is a very fragile thing and, also, the portion of the market affected by such loyalty is minute. For both these reasons, the arguments of Denenberg and Cummins are completely unpersuasive.

In cases 4, 5, 6 there is no degree of monopsony power in the purchase of Industry III's output. If $S_1$, $S_2$, ... are not blocked from fully exploiting their oligopoly power they will use their power directly to increase their selling price to Industry I, and reciprocity will not enter the picture. If reciprocity does occur, it will be initiated by one of the oligopolists, e.g., $S_1$, who wishes to get B's business by tacitly cutting the price by agreeing to buy from A at a higher price. This tactic will be of little value to $S_1$ since B buys only a very tiny proportion of Industry III's output. Therefore the impact on Industry II is also very small. Finally, any one of $S_1$'s competitors can offer similar reciprocal arrangements. In these cases the impact in terms of Industry III will be pro-competitive.

In cases 7, 8, 9 the output side of Industry III is a monopoly. It is hard to see how such a firm could make use of reciprocity to improve its position. As Mueller points out, "A monopolist...has no need to engage in a reciprocity program; as the sole supplier of a particular product, it can derive no advantage from such a mutual arrangement."[134] Note also in all of these cases, Firm B, by definition, has no buying power so there can be no initiative for reciprocity from that direction. Therefore, there will be no impact on the structure of Industry III or Industry II.

In case 10, Firm B together with its fellow oligopsonists has a degree of buying power. If this power is exploited directly reciprocity will not be used, rather B and its competitors will receive lower input prices ( if the supply curve of Industry III is upward sloping) in what it buys from $S_1$, $S_2$, .... B might wish to transfer some of its buying power or if blocked, use its power to help its affiliate A. But in no way can it make $S_1$, $S_2$, ... worse off (less than normal profits) as they are in a perfectly competitive industry. As long as the net position of the firms in Industry III is made no worse, B may be able to get them to buy from A. But A's share of Industry II's output could not increase very much before the firm's selling to B would observe that concentration in Industry II was increasing to their disadvantage. Note that A's share may be increased, but not its rate of return since it operates in a perfectly competitive industry, and if it raised its price to $S_1$, $S_2$, ... others would undercut. It is important to realize that obligopolists or a monopsonist can "exploit" a

perfectly competitive industry, but not the individual firms in the sense that they fail to earn normal returns. Therefore, in case 10, there is no impact on Industry III and only a very slight impact on Industry II. In case 11, there is already an oligopoly in Industry II that would tend to result in higher input prices for Industry III as a whole. Firm B could induce the firms it buys from in Industry III to buy from its affiliate A, but only on a *ceteris paribus* basis. Competitors of A can, by dropping the price slightly, overcome the reciprocity arrangement. But individual firms in Industry III, being perfectly competitive in output, and also perfectly competitive in the purchase of their inputs, cannot be driven below normal returns, where they were already before reciprocity was initiated. Coercive reciprocity is out entirely. Because of the market structure of Industry III, the firms are already earning only normal profits and can incur no additional costs. By going along with B by agreeing to buy from A they increase the level of concentration in Industry II. Since there are no offsetting benefits it is hard to see how B will be able to get $S_1$, $S_2$, ... to go along with reciprocity.

In case 12, A already has a monopoly and is presumably making full use of it. It doesn't need B's help. There will be no reciprocity, other than the coincidental or convenience type and no impact on Industry II or III.

Cases 13 and 14 possess the richest possibilities for reciprocity, particularly if the direct use of market power by B et al. Industry I or $S_1$, $S_2$, ... in Industry III is inhibited. In general, the equilibrium price and output of an oligopoly facing an oligopsony is indeterminate. Suppose the market power of the oligopolists ($S_1$, $S_2$, ...) is somewhat greater than that of the buyers (i.e., the solution favors $S_1$, $S_2$, ... relatively more than it does B et al.). Then a firm such as S may offer to buy from A at higher prices to give B a secret price cut. Since $S_1$'s competitors can offer the same deal, reciprocity is pro-competitive in terms of Industry III. However, $S_1$, by offering reciprocity, has to recognize that it may increase A's share of Industry II to the point that A will have a degree of market power (case 13) or an increased degree of market power (case 14). Where the reciprocity is inititated by $S_1$ or $S_2$ ..., it is not a unique weapon that cannot be employed by others in Industry III. In view of its potential effects on Industry II (from whom Industry III buys), reciprocity will not be very extensive and will be pro-competitive force. In his thesis, Finney states that where there is oligopoly on both sides of the market (he dealt only with the two-industry case) his interviews "showed it to be an area of very active reciprocal dealings."[135]

He notes that no premium prices were paid and that competitors were free to retaliate in kind, therefore there was no foreclosure.

Citing the case of reciprocity between chemical producers and paper and packaging firms he states "only if a chemical company has a division unique to itself which is a large packaging user does the company have an opportunity to foreclose a part of the market to its competing chemical manufacturers."[136]

Suppose the oligopsonists such as B tend to dominate the oligopolists such as $S_1$, $S_2$, .... Reciprocity will enter only if B chooses to transfer some of its power to benefit A or if B is blocked in the full use of its monopsony power. The second situation is more significant. Here B may well be able to increase A's profits and market share at the expense of its suppliers in Industry III. $S_1$, $S_2$, ... may not be able to resist having A increase the concentration of Industry II. Because B's competitors (in the purchase of Industry III's output) do not also have a position in Industry II to engage in reciprocity B has a competitive weapon. Finney argues that:

> The single most useful measure of a situation dangerous to market competition...<u>is the presence in the selling unit's industry of a non-reciprocating sector</u>...the presence in the selling unit's market of competitors unable to retaliate to reciprocal tactics.[137]

He emphasized that the inability to retaliate with reciprocal dealing.[138] For these reasons, Finney concludes that the necessary and sufficient conditions for reciprocity to result in market foreclosure are:

a. The possession of leverage by the initiating firm in its role as a buyer, and

b. The inability of the firm's competitors on the selling side to retaliate in kind to reciprocity.[139]

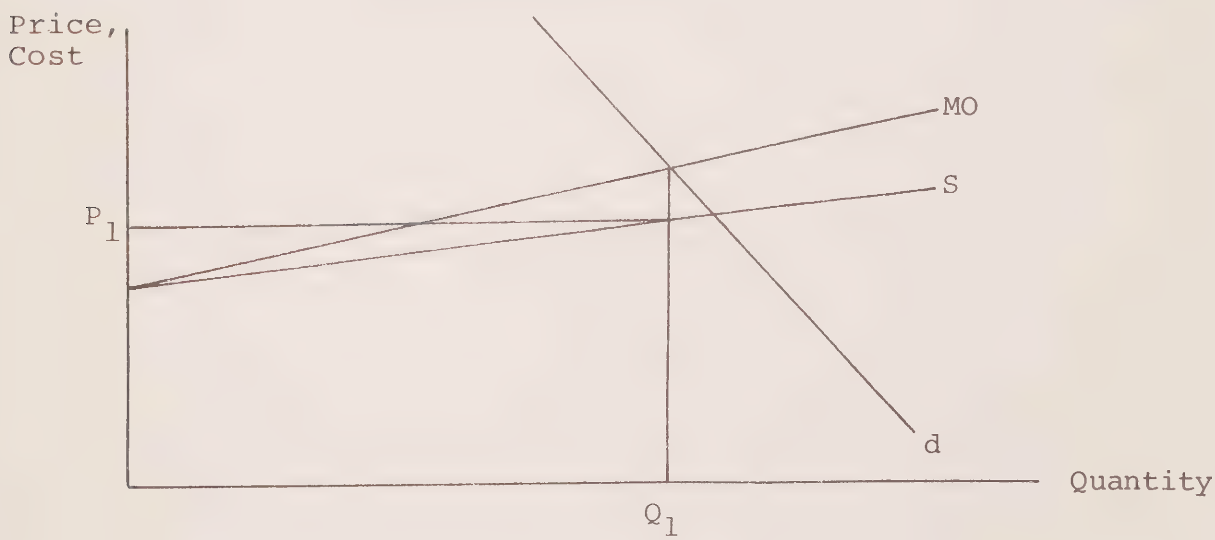
In its strongest form, Finney's argument implies that other companies tactics are not commensurable with reciprocity. In case 13, A's competitors can't cut price as they are only earning normal profits. However, in case 14 where Industry II is an oligopoly that option appears open although the interdependence of competitors limits the use of such tactics. Therefore cases 13 and 14 seem to be the ones in which the greatest impact on the structure of Industry II is possible. Under the conditions we have outlined (oligopsony power that would otherwise be unutilized, outweighing the oligopoly market power of suppliers and where Industry II is competitive or an oligopoly) the impact of reciprocity will be anticompetitive and undesirable from the point of view of public policy. Case 15 is less interesting since A already has a monopoly in Industry II. Reciprocity is unnecessary to improve A's position and will occur only because of inherent market structure and the ownership links between B and A.

In cases 16, 17, 18, the monopolist in Industry III will tend to dominate the oligopsony it faces. Any reciprocity will be initiated by $S_1$ (the only producer) and only if the direct use of its power is blocked. $S_1$ might use reciprocity to facilitate otherwise illegal price discrimination in its sales to B and other buyers in Industry I. The effectiveness of this tactic depends on B's position as a seller of Industry I's output, i.e., the extent to which B's derived elasticity of demand for what it buys from $S_1$ as compared with the other firms in Industry I. If discrimination in the firm of reciprocity pays for $S_1$, B would be made worse off but A's market share in Industry II could be improved. It is highly unlikely that the use of reciprocity to practice price discrimination by $S_1$ could have much of an impact on Industry II. $S_1$ has to be careful not to concentrate the industry as a purchaser of Industry's II's output. We conclude that $S_1$'s offer of reciprocity could have a minor impact on Industry II. In case 19, firm A already has a monopoly so no reciprocity would occur except that inherent in the industry relationships and the common ownership of B and A.

In cases 19, 20, 21, there is a single buyer of Industry III's output which is produced by many firms, each with an insignificant proportion of total output. If the single buyer (e.g., B) in Industry I is not constrained in the use of its monopsony power he will almost certainly use it directly to lower input prices (in the face of an upward sloping supply curve) and purchase a smaller volume of output (in the face of either an upward sloping or horizontal supply curve). Consider Chart 5 below.

CHART 5

UNCONSTRAINED MONOPSONY

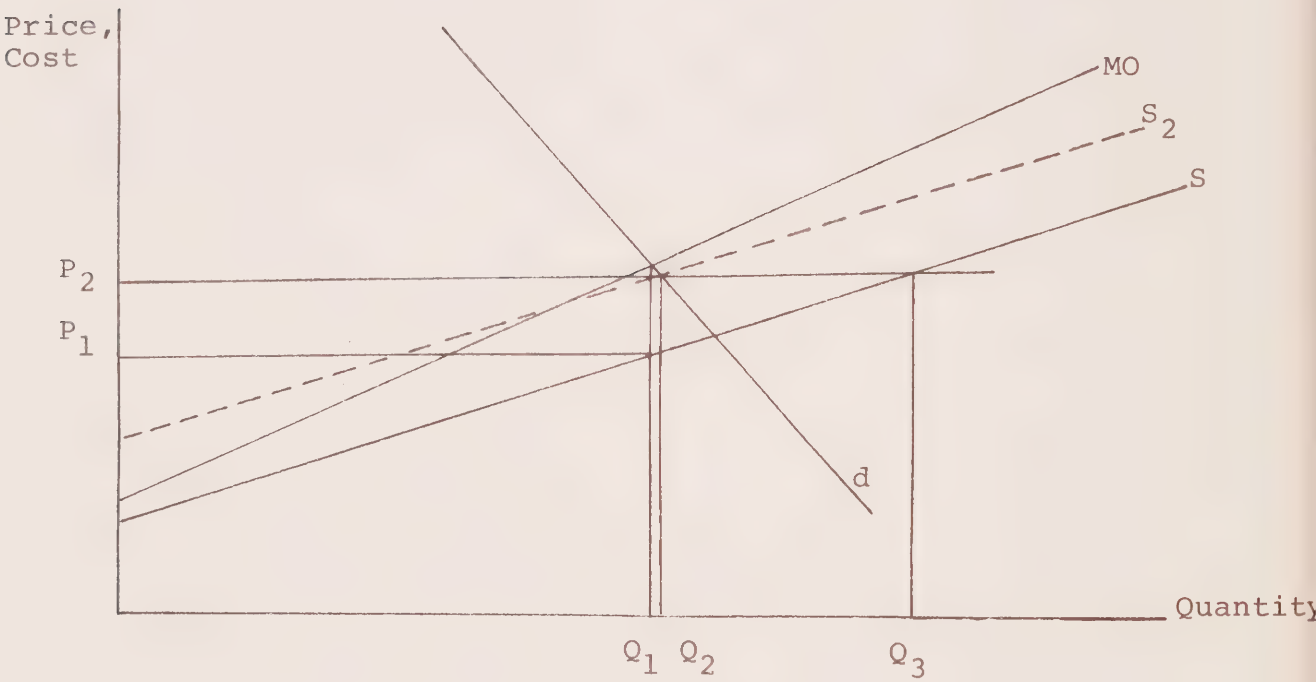


Here S represents the supply curve for the output of Industry III produced by many small firms. If we assume B cannot discriminate among his suppliers, he recognizes that the more he buys the more he must pay to all producers. Therefore MO represents the marginal outlays as B buys more. Equilibrium output ($Q_1$) is determined by the intersection of MO and d, the net value to the monopsonist of an increment to his purchases of Industry III's output at various levels of quantity. Equilibrium price ($P_1$) is determined by the level of S at $Q_1$. Note that the industry ($S_1$, $S_2$, ...) is being "exploited", but individual producers still receive normal returns.

Suppose now the government sets a minimum price ($P_2$) above what would have occurred in the absence of any intervention ($P_1$). We move to Chart 6 below.

CHART 6

CONSTRAINED MONOPSONY




At the government-mandated minimum price of $P_2$ the firms in Industry III are willing to supply $Q_3$, but Firm B is willing to buy only $Q_2$ and B has a problem of rationing among firms $S_1$, $S_2$, .... One solution is to use reciprocity to shift the supply curve up to $S_2$. Therefore, B acquires A in Industry II

and says to those in Industry III who wish to sell to him at $P_2$ that they must buy from A at higher prices. The firms who agree get B's business and their costs rise since they pay more to A than they would to A's competitors in Industry II. Obviously A's share of the market increases so what B lost through government intervention, which raised the price of his inputs from Industry III from $P_1$ to $P_2$, he can recoup from owning A and engaging in reciprocity. It should be obvious that what we have just outlined is what occurred in the Waugh Equipment and Mechanical Manufacturing cases in the 1930's.[140] Armour and Swift (i.e., Firm B) were not pure monopsonists, but they had significant monopsony power. The railroads ($S_1$, $S_2$, ...) were not numerous but a number of suppliers were competing for their business. It was the ICC which by trying to prevent Armour and Swift from using their monopsony power, created the conditions for reciprocity.

In cases 19 and 20, a monopsonist who is blocked in the direct use of his power can clearly, through the ownership of A in Industry II, foreclose a portion of Industry II's output. The proportion depends upon the significance of that output. The more important Industry III as a whole is as a buyer of Industry II's output the greater the extent of foreclosure. In case 21, of course, A already has a monopoly, and if it is at the profit maximizing position, B's help via reciprocity is meaningless.

Cases 22, 23, 24, will have the same general result as cases 19, 20, 21. The monopsonist, if blocked from using all its power directly will use reciprocity to circumvent regulated tariffs (the price at which it buys) or to overcome oligopolistic coordination of $S_1$, $S_2$, .... As a result, in the second situation, Firm B may stimulate competition among $S_1$, $S_2$, .... However, the loss of oligopoly-based excess profits by $S_1$, $S_2$, ... will benefit B or alternatively its affiliate A. In cases 22 and 23, B may well be able to increase A's share of Industry II and to increase A's profits at the expense of A's rivals. In case 24, where A already has a monopoly, reciprocity induced by B will be meaningless to A's position.

In cases 25, 26, and 27, we have bilateral monopoly in the production and purchase of Industry III's output. The equilibrium position is indeterminate within a wide range. In either the constrained or unconstrained case (for either B or $S_1$, the sole seller in Industry III) induced reciprocity will be meaningless. If $S_1$ is constrained by government regulation and B is not, in case 26, Firm A will probably be able to improve its position over the unconstrained case, but this has nothing to do with the common ownership of B and A. Empirically cases 25, 26, and 27 will be very rare and when they do occur any reciprocity results from the natural input-output relations among the industries and the joint ownership of B and A. Reciprocity will not be a competitive tactic.

Throughout the foregoing we have focused the discussion on the impact that reciprocal dealing could have on the market structure (primarily level of concentration and barriers to entry) of the supplier industry and the industry which is believed to be assisted by the reciprocity. We have found that where reciprocity is initiated by oligopolists it tends to be pro-competitive in effect by offering a way to engage in tacit price-cutting. Monopolists have no need to use reciprocity. A monopsonist can make effective use of reciprocity only if it is blocked from using its power directly. If it is buying from a competitive industry it can help its affiliates (who supply the monopsonist's suppliers) only slightly in the form of ceteris paribus reciprocity, but cannot impose higher costs on these suppliers. A monopsonist (or a group of firms with monopsony power) who could not otherwise use its buying power directly, can best use its leverage against a supplier industry which is imperfectly competitive (but not a monopoly). Through reciprocity it may well be able to increase its affiliate's market share and profitability. Entry or expansion by rivals will be made more difficult since larger price cuts will be necessary to indemnify potential buyers (who are also sellers to the monopsonist) against the loss of profits on sales to the monopsonist. This additional barrier to entry occurs because reciprocity is a vehicle for the otherwise unutilizable monopsony power.

It is hard to believe that, empirically, there are a large number of such situations which would act as a strong incentive to engage in either offensive or defensive mergers and thus increase aggregate concentration. Professor Mueller's fears that reciprocity is or could be a major force in increasing aggregate concentration seems very greatly exaggerated.

## MANAGERIAL ASPECTS OF RECIPROCAL BUYING

### THE BENEFITS AND COSTS OF RECIPROCITY

Leonard S. Simon develops a normative model for reciprocal decisions from the point of view of the firm. He points out that "if seen from the viewpoint of the firm upon who reciprocal persuasion is being applied, reciprocity appears as a means of preventing its own demand curve from being shifted to the left."[141]

Hence, "reciprocity is a defensive rather than an offensive form of behavior".[142] He goes on to provide a formal decision-making model which has as its objective the maximization of the firm's net contribution margin.[143]

In looking at the decision to engage in reciprocity from the vantage point of the firm who is on the "receiving end" of the dominant partner's initiative for reciprocal dealing, Simon

recognizes that the firm must look at its net position as a result of agreeing to engage in reciprocity. The firm must compare its margin on increased sales (or contribution margin on the next best sales prospect if the offer is simply to maintain sales) with any increased costs of purchases (ceteris paribus) resulting from the reciprocal purchase/sales.

Simon notes that the profitability of reciprocity as a business practice depends on the extent to which a firm's competitors can offer reciprocal dealing: "If all firms participate in reciprocity and so do all the firms with whom they trade, there is not likely to be any net benefit to the individual firms from the practice itself, beyond the initial readjustments."[144] In this case, the initiator can gain only a short term advantage. However, Simon points out that where "there are ultimate consumers or competitors who do not possess reciprocal power, reciprocity does work to the benefit of some, if not all, of the firms employing it since the nonreciprocators--possibly through the payment of higher stated prices or the absence on non-price concessions--must provide for these profits produced within the reciprocal system."[145]

Simon focuses on the formal optimization problem, but he does not discuss the nature and form that the managerial benefits and costs from reciprocity can arise.

Reduction of Transaction Costs?

We have pointed out that convenience reciprocity will not occur unless both parties are better off as a result of reciprocity. This may occur because each firm's buying and selling costs are reduced. Less sales effort (and expense) are required when part of the market for a firm's output is assured. Similarly, information costs of seeking the best available deal on inputs are reduced if the firm has an assured source of supply. Keeshan observes that "if a pair of suppliers-customers is reasonably certain that each is a low-cost producer, reciprocity will allow each to expend less sales effort on the other, thus reducing unit selling costs and freeing the saved sales effort for other accounts. In effect, reciprocity performs a function similar to requirements contracts, eliminating the need for periodic sales promotion and lowering the price of the product to each firm by an amount equal to its savings in selling costs."[146]

By reducing mutual selling costs, Ferguson asserts, "reciprocity may reduce the costs of competition in each industry."[147] Ferguson provides no empirical evidence to support his assertion, but in theory he is, of course, correct. Yet we should not conclude that both the private and social benefits from reciprocal dealing by firms operating in competitive markets

is large. The condition that all relevant markets are competitive means that information and selling costs cannot be very important. Ferguson, following Stigler's point, that the dispersion of sellers' asking prices is ubiquitous even for homogeneous goods, notes that both firms cannot save the costs of acquiring information over time (as the identities of sellers offering the best terms changes) except by paying a higher price for the goods in question.[148] As we have noted, Ferguson's point that the fact that reciprocity is practiced by firms without market power is strong evidence that there are legitimate reasons for practicing reciprocity. It is interesting that it is a Chicago school economist making the point that reciprocity reduces selling/buying costs, for we could find no similar argument made by businessmen or by professors of management. Indeed, their opinions are that such costs will rise under the practice of reciprocity.

Neuhoff and Thompson provide examples of the view that reciprocity has an undesirable impact on buying/selling costs:

> Reciprocal selling works against the seller as it destroys the inititative of the salesman and usually in the end becomes an aid for poor management with a consequent lowering of morale of the company whcih uses reciprocity.[149]

> ...reciprocity is an undesirable business practice since it interferes with sound purchasing policy and causes emphasis to be placed upon other than the important purchasing considerations of quality and price.[150]

Sales Management described reciprocity as a "dangerous selling tool" and set out eight "pitfalls awaiting all but the most sophisticated users of reciprocity."[151] A number of these could more than offset any transactions economies. They point out that reciprocity creates "false markets" in that "a big-company customer can suddenly decide to demand a lower price or even buy elsewhere", thus a large chunk of business can be lost. Reciprocity can create a "false sense of security" in that reciprocal deals may be comfortable but the firm may fall behind in marketing innovation or production and engineering know-how. Dependence on reciprocity could lead competitors to engage in similar tactics and thereby tie up potential customers.
As reciprocity is used to make sales, if it results in higher input costs these costs should be recognized as additional selling costs. Reciprocal dealing often absorbs top management time directly or in the form of a trade relations department. Finally, reciprocity adversely affects the morale of purchasing agents with negative repercussions on managerial effectiveness.[152]

Dean S. Ammer, in the Harvard Business Review, argues that reciprocity "is inherently unprofitable" and that it "raises most companies' purchasing costs."[153] He gives three reasons: (a) "Reciprocity weakens and sometimes even destroys, supplier price competition", (b) "Reciprocity permits sloppy supplier performance", and (c) "Reciprocity promotes sloppy purchasing."[154] On the other side of the reciprocal exchange Ammer asserts that the sales department cost and performance "usually suffer when a company sells on the basis of how much it buys rather than on the basis of product superiority."[155] He argues that "salesmen become complacent" and neglect their reciprocal accounts and may fail to get the maximum business possible out of such accounts. Where reciprocity is important the salesman becomes an order clerk. Second, "reciprocity downgrades a company and its product", i.e., it implies that its product is no better than that of its competitors.[156] Birdzell echoes this last point when he says, "The distaste of many firms for reciprocity arises precisely from the necessity of admitting that its competitors really are equal to it in price, quality, and delivery. Such admissions are more than distasteful; they present substantial problems of morale and motivation within the business organization."[157]

It is usually argued that the large diversified firm has the greatest potential to practice and to benefit from reciprocity. It may be surprising then, that the president of one of the largest conglomerate enterprises, International Telephone and Telegraph (sales in 1969 of $5.5 billion) should be a vociferous critic of reciprocity. Harold S. Geneen has stated:

> The theory of reciprocity is...repugnant as a basic business philosophy...it is my belief that efforts to purchase and sell goods or services on the basis of socalled "reciprocity" are completely uneconomical and are, in fact, a very unsound business practice. Such a practice dulls and distorts the efforts of both sales and purchasing staffs, dilutes the management responsibility for profits, and, in the long run, is certain to be costly and enervating to any company that practices it.[158]

Later he argued that "reciprocal buying and selling 'gains' are largely illusory--and are more often 'talked about' or 'claimed' by self-serving trade relations directors, than ever realized on any significant scale."[159] In ITT Geneen maintained a strong written policy against reciprocity since 1966.[160] In addition, his emphasis on decentralized purchasing and sales departments in each operating unit or profit center, together with managerial compensation geared to divisional performance, would have had a severe inhibiting effort on reciprocal dealing.[161]

Weigand, in his analysis of the problems of managing reciprocity, notes that the cost of administering a systematic reciprocity program can be significant.[162] The firm's immediate suppliers must be identified, and their potentiality as customers must be estimated. Decisions must be made as to what share of each supplier's business the firm will seek to achieve. Weigand argues that "firms capable of practicing reciprocity do not always ask for all of their bond-partners' patronage, but only for an amount that is considered fair."[163] The next step is to implement the program. Because of increased antitrust sensitivity this must often be done through top level executives of both firms. Referring to the Special Sales Program in the General Dynamics case Weigand states, "it obviously required substantial sums of money to operate."[164] He goes on to point out that reciprocal dealing tends to be handled by senior executives, "the people at the lower levels in the firm being unaware of the exact nature of the negotiations or their reasons...since the heart of the buying decision has already been made, the remaining work is not only trivial but is perceived to be so by those involved."[165] When coupled with the fears of sales and purchasing executives that their firm may be unable to compete on the usual basis of price, quality, and service, the impact on organizational morale can be serious. Reciprocity is not just another sales tool. It is, as we have noted above, an ethically ambiguous practice with far more critics than proponents. In an article published in early 1962, before the antitrust attack on reciprocity, Ammer observed that not a single executive interviewed in connection with the preparation of his article was willing to be quoted directly about reciprocity.[166]

## Reduction in Uncertainty?

Ferguson argues that "to have assured customers for one's products may reduce uncertainty concerning sales for each of the parties to a reciprocal purchasing agreement."[167] Keeshan asserts that "reciprocity will make a certain portion of sales and purchases fixed, and thus enable the firm to predict overall cash flows with greater certainty."[168] As a result financial planning and production scheduling may be improved. Ceteris paribus, business executives who are averse to risk will prefer less variance in sales, production, and production to more. What we have called "time reciprocity" can be seen as a form of insurance whereby a firm practices reciprocity to insure itself an adequate supply of an essential input in times of shortage.[169]

But it is not at all obvious that systematic reciprocal dealing tends to reduce uncertainty. If a firm deliberately concentrates its purchases to avail itself of purchasing leverage to increase sales, it may find itself hostage to a smaller number of suppliers than would otherwise be the case. Consider the following case in reference to Chart 3, page 68. Suppose

Industry I as purchasers of the output of Industry III is an oligopoly. Assume that Industry II is perfectly competitive in the production of the output it sells to Industry III and that Industry III is perfectly competitive in the production of the good it sells to Industry I. Firm B in Industry I has a degree of monopsony power which it can use to increase the sales of its affiliate A (in Industry II) to its suppliers in Industry III provided it imposes no higher costs on the firms which are suppliers to B than on the suppliers' competitors. This form of _ceteris paribus_ reciprocity could possibly increase A's share of Industry II's market as high as the proportion of B's purchases of the total output of Industry III. While no higher costs are being imposed on B's suppliers (e.g., $S_1$ and $S_2$) the cooperating firms must surely realize that by going along with B and purchasing from A they are increasing the seller concentration in Industry II. Firms in Industry III who are suppliers of B obtain no economic benefit by accommodating B's wish that they buy from A rather than A's competitors in Industry II, but the effect of doing B's bidding is to increase seller concentration among the firms in Industry II, _their_ suppliers. As a result, it seems likely that $S_1$ and $S_2$ and other suppliers of B may increase their purchases from A, thus increasing A's market share, but not so much as to give A any effective market power. If B protests and refuses to buy (or decreases purchases) from $S_1$ and $S_2$ these firms, operating in a perfectly competitive industry, can continue to sell all they want at the market price. B's threats are only a minor inconvenience.

Promotion of Goodwill?

Keeshan argues that reciprocity may be used as a form of non-price competition in order to obtain the goodwill of a supplier/customer. If inputs are purchased at competitive prices, then goodwill is increased a little or no cost. If higher prices are paid to a supplier/customer for the inputs he supplies, then these are a sales promotion cost and should be recognized as such.[170] Stocking and Mueller cite an article in the _New York Times_ in 1932 in which it stated, "it was decided by the majority of companies to charge the difference in the cost of products to sales expense when reciprocity was involved. In this manner the extra expense is definitely charged to one department and the added cost brings to sales divisions a realization of their responsibility in making reciprocal arrangements."[171]

In the context of oligopoly or oligopsony, reciprocal buying can be used to increase the strength of trading relationships between firms who are each other's customers. The oligopolist can use the favor of his patronage as a purchaser to discriminate among his customers and yet still maintain the rigid list price structure that is a hallmark of the oligopolistic industry. A firm in a competitive industry has no such motivation; under normal conditions he cannot discriminate effectively between

customers, and he can compete directly with other firms in the industry by lowering his prices. As we have noted, this particular use of reciprocity may be somewhat beneficial. Reciprocity may be used by the individual oligopolist to avoid industry list prices in a way that would be very difficult for other members to detect.

In the real world, relations between firms cannot be completely summarized by transaction prices. Reciprocity can be used to oil the interactions among enterprises, the managers of which (particularly when they have a modicum of discretion, as they often do) recognize that circumstances change and that most transactions are not isolated, but are part of a continuing series. Commercial reciprocity is consistent with social values concerning reciprocity.[172] It can be used to complement the purely economic element of market exchanges. This point is clearly seen in the words of the former Director of Trade Relations of Jones and Laughlin Steel when he stated:

> We are morally obligated to consider those people who have befriended us in the matter of purchases. Conversely, we feel it is just as important to emphasize the fact that when we need help we should feel free to call upon our commercial friends to help us in the matter of our sales, just as we have helped them.[173]

We do not wish to overemphasize this point. But we do wish to recognize that a firm could use reciprocity, not as a vehicle to use otherwise unexploited market power, but as a means of improving relationships with customary suppliers which may, in the future, be of direct economic value. Such actions in themselves are likely to have virtually no adverse economic impact and, would in any event, be beyond the reach of antitrust. Any "advantage" such actions would be small and easily overcome by competitors seeking to improve their position. Like the icing on a cake, reciprocity as a means of generating goodwill adds a thin veneer and sweetens the deal, but is no substitute for the cake itself.

## ORGANIZATIONAL IMPLICATIONS

Finney argues that for a corporation to use reciprocity in a planned and systematic manner to increase sales three things are necessary: (a) "top management must be aware of and condone, if not actively support, the strategy, (b) data processing systems must provide the relevant information; and (c) someone in the firm must perform the actual coordinating function in the name of top management; all of which means there must be an enabling intra-corporate organization."[174]

The discussion in this section can be highlighted by looking at the problem the other way around, in terms of the arguments raised by defendants in reciprocity cases the citing aspects of intra-firm organization over which they have control that have the effect of severely inhibiting or preventing reciprocal dealing. First is existence of a multi-divisional structure in which each division is an independent profit center, i.e., responsible for both revenues and expenses. Related to the profit center concept is the point that managerial incentives are closely related to the performance (profitability) of individual profit centers. Second would be the segregation of purchasing personnel and information from sales personnel and information and the failure to collect at all the information necessary to engage in systematic reciprocity. Third is the adoption and reinforcement of an anti-reciprocity policy by top management. These issues were discussed in the three ITT cases,[175] White Consolidated and White Motor,[176] Penick & Ford,[177] and have formed an important element in the three-dozen consent decrees obtained by the Department of Justice.[178]

Although it is easy to see that these measures will reduce the likelihood of the use of reciprocity potential, it is much more difficult to go a step further and conclude that they will prevent any significant practice of reciprocity. While the existence of profit centers within a conglomerate may make it more expensive for corporate managers to exercise aggregate corporate purchasing power, there may still be net benefit to the firm from doing so. Thus reciprocity may remain a valuable marketing technique. Cooperation between profit centers is still possible.

We have noted Williamson's argument that M-form organizations are less given to reciprocity than U-form firms, *ceteris paribus*. However, in the same book, Williamson notes that in large integrated firms there is a bias toward internal procurement, i.e., "subgoals of a group or bureaucratic sort are easily given greater weight in relation to objective profitability considerations."[179]

As we shall point out in the discussion of the ITT-Hartford case below, the managers of different profit centers can cooperate to practice reciprocity. We should also note that there may still be considerable reciprocity capacity (independent of the rest of the organization) left in individual profit centers independently of the structure of the firm as a whole. Moreover, as Chief Judge Battisti noted in White Consolidated Industries, the reality of corporate incentive and responsibility may be somewhat different from the theory of the corporate organization chart:

> The defendants' attempt to minimize the anti-competitive impact of their proposed merger by speaking of the so-called" profit-center" system under which they claim

White Consolidated operates. Each division, they argue, is responsible only for its own internal profitability, As a result, the Court is told, no division will practice or encourage reciprocal dealing in favor of another, since this would harm its internal situation. The evidence and testimony presented to this Court, however, indicates a much firmer and more centralized control than the defendants would have us believe; and it would appear that it is overall corporate profits, not divisional ones, which are of paramount importance to White Consolidated's central office.[180]

In the ITT-Canteen[181] and ITT-Hartford[182] cases, ITT President Geneen stressed the decentralized nature of the divisional profit centers hence the lack of incentive for divisional managers to engage in reciprocity. But in an article published at about the same time Geneen stated that ITT did not operate as a holding company, but rather "on the basis of a coherent operating company with a substantial central operating management."[183] He pointed out that at that time (1969) ITT had 2,000 industrial and operational specialists in its central management group.[184] The point is that the true conglomerate (as opposed to a holding company) is a peculiar mix of decentralization of some functions and centralization of others. If decentralization is as great as Geneen would have us believe, ITT could not effectively employ 2,000 executives in its central office. His statement that if a divisional manager were ordered to engage in reciprocity that "all of [ITT's] techniques of responsibility and accountability for performance would be competely destroyed"[185] is hyperbole. Anthony Sampson writes:

> It is implicit in Geneen's whole system that no man is given full responsibility for anything, and the more senior the managers, the more they are subject to inspection, checking, and cross-checking. The chief executive of a huge subsidiary may appear to be his own master, but each department will be supervised by the experts from head office....[186]

One must also question the weight given to the fact that a firm does not collect the sales and purchasing data required for reciprocal dealing. First of all, one must distinguish between the practice of collecting data and the capability of so doing. Although there may be no evidence of data collection, reciprocity may still exist (although Judge Austin in ITT-Canteen would have one believe otherwise).[187] No modern-day business of the size involved in most of the reciprocity cases can function without fairly sophisticated sales and purchasing data. It would not appear to be too difficult for interested executives to extract

the appropriate data by purchaser-supplier from a sophisticated management information system.

It has been suggested that systematic reciprocity only became possible with the advent of the computer. But, long before the computer, Armour & Co. and Waugh Equipment were able to conduct a highly successful reciprocity campaign. Even among today's much larger corporations, surely many of the more promising opportunities for reciprocal dealing are self-evident. One must concede that it would be nice as a salesman to be able to confront suppliers who are reluctant to purchase with a computer program showing exact sales and purchasing figures as Liquid Carbonic and Airco[188] officials were in the habit of doing. Surely Ingersoll-Rand's marketing executives know who their steel suppliers are, who buys coal equipment, and what the corporation relationships are in between these decisions. Similarly, Gentry salesmen would know or could easily find out that Consolidated Foods has purchased Gerber baby food and that Gerber was not purchasing its onion requirements from Gentry without having to refer to a computer print-out.

Finally, one must be careful of evidence of an anti-reciprocity "policy". When such a policy is merely evidence of present management's stated intentions, it should not be given the same weight as evidence that the company has reinforced its statement by appropriate behavior when the policy was not followed. In the Northwest Industries case the judge commented:

> ...while the President of Northwest [Mr. Heineman] testified that the company had a policy against the use of reciprocity, he did not know of any written statement of such policy that has ever been disseminated to the various companies within Northwest...it is apparent that any comprehensive policy against reciprocity is a fairly recent development and a reflection of the personal philosophy of Mr. Heineman.[189]

In the ITT cases the large conglomerate argued that it had a strong written policy against reciprocity since 1966 and an unwritten one prior to that. "This policy [was] widely disseminated among ITT's purchasing and sales personnel on a continuing basis."[190] In ITT-Canteen, Judge Austin noted that the Government's exhaustive search for any instance in which any ITT subsidiary engaged in reciprocal dealing in the five-year period prior to that acquisition was completely unsuccessful.[191] For these reasons it is not difficult to see how Judges Timbers and Austin could conclude that ITT's policy against reciprocity was an operational fact rather than a stated intention.

An official of the Federal Trade Commission, in an article entitled: "The Making and Selling of an Antireciprocity Program" stated: "It is not sufficient for...[a corporation] to declare itself against reciprocity. The practice has been around too long and has been too warmly embraced by the business community for mere policy statements to have much effect."[192] He went on to say that corporations "all too frequently issue policy statements which merely copy provisions in the Government's requests for relief in reciprocity matters."[193]

But the Justice Department and the FTC can't have it both ways. This point was made by Judge Austin in the ITT-Canteen case where he pointed out that the Department of Justice's position in criticizing the safeguards instituted by ITT was seriously compromised by the inclusion of many of those same safeguards in consent decrees negotiated by the Department.[194]

# CHAPTER 6

# RECIPROCAL BUYING AND THE LAW

## THE STATUTES[1]

U.S. antitrust authorities have three statutes available with which to attack reciprocal dealing, the Federal Trade Commission Act, the Clayton Act, and the Sherman Act.

Used first in the 1930's but since fallen into disuse is Section 5 of the Federal Trade Commission Act, originally passed in 1914. It declares illegal "unfair methods of competition in commerce, and unfair or deceptive acts or practices in commerce..." The words "and unfair or deceptive acts or practices of commerce..." were added by the Wheeler-Lea Act of 1938. Section 5 was used by the FTC to successfully prosecute three cases of coercive reciprocity, Waugh Equipment[2] (1931), Mechanical Manufacturing[3] (1932), and California Packing[4] (1937). The first two cases involved fraudulent reciprocal dealing as defined in Chapter 3.

The bulk of the contested cases have occurred under Section 7 of the Clayton Act, which incorporated the Celler-Kefauver Act of 1950. This anti-merger statute, covering acquisitions by means of the purchase of share capital or assets, makes illegal those acquisitions "where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition or tend to create a monopoly." Nine cases, instigated by the Federal Trade Commission or the Justice Department were decided under Section 7 by the end of 1975. They were: Consolidated Foods[5] (1965), ITT-Canteen[6] (1971), ITT-Grinnell[7] (1970), ITT-Hartford[8] (1969), General Dynamics[9] (1966), Northwest Industries[10] (1969), Penick and Ford[11] (1965), Ingersoll-Rand[12] (1963), and White Consolidated[13] (1971). In addition, two private suits dealt with Section 7: Allis-Chalmers v. White Consolidated[14] (1969) and Stavrides v. Mellon National Bank[15] (1973).

The third statutory vehicle that has been used to attack reciprocal dealing, the Sherman Act, was passed in 1890. Both Section 1 and Section 2 of this act have been brought to bear. Section 1, the basic conspiracy section, states in part, "Every contract, combination in the form of trust or otherwise, or conspiracy in restraint of trade or commerce among the several states, or with foreign nations, is hereby declared to be illegal...". This section can be used to attack reciprocity agreements. Section 2 deals with monopoly and monopolization It states, "Every person who shall monopolize, or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several states, or with foreign nations,

shall be deemed guilty..." The Department of Justice has argued that reciprocal dealing can, under certain circumstances, amount to an attempt to monopolize.

By the end of 1975, only two cases had been brought by the government under with the Sherman Act. General Dynamics (1966) involved both Section 1 of the Act and Section 7 of the Clayton Act. The Airco case,[16] decided in late 1974, addressed both Sections 1 and 2 of the Sherman Act. Three private cases have added to the law on reciprocal dealing under the Sherman Act: Gore v. Carlisle[17] (1974), Carlson v. Sperry & Hutchinson[18] (1974), and Columbia Nitrogen v. Royster[19] (1971). The first two dealt with both Sections 1 and 2, while the third addressed only Section 1.

## CONTESTED CASES VERSUS CONSENT DECREES

The antitrust attack on reciprocal dealing has resulted in as many consent decrees as contested cases. By the end of 1975, the FTC or the U.S. Justice Department had obtained a total of 34 consent decrees in reciprocity cases. Five of these decrees involved both divestiture and reciprocity prohibitions. By comparison, only 12 contested cases initiated by the government were decided by the end of 1975. Three of these involved cases in which the final decision was made by the FTC rather than the courts. There have been six private cases in which the courts have dealt with reciprocity as a substantive matter. But only one of these (Allis-Chalmers v. White Consolidated) could be described as being of major significance in the development of the law in this area.

A consent decree represents a negotiated settlement between the Justice Department and the firm under investigation. Presumably such a settlement is reached because neither party is willing to gamble on the final outcome in a trial or to appeal on the merits of the case. Alternatively, both sides see it as a convenient and less expensive process than "fighting it out" through the courts. The Justice Department may accept a lesser remedy and the "defendant" firm is willing to be enjoined from certain practices or divest itself of an acquisition rather than face both the certain cost and uncertain outcome of regular judicial proceedings.

Interpretation of the law on reciprocity, in the form of decided cases, is made difficult by two additional facts: (1) There are almost no "pure reciprocity" cases. Reciprocity is often only one of a number of issues under dispute. Most often the central issue is a merger/acquisition and reciprocity is introduced as part of the evaluation of the competitive impact of the merger. (2) There is only one Supreme Court ruling on reciprocity--Consolidated Foods (1965), and two additional appeal court decisions, Ingersoll-Rand (1963), and Allis-Chalmers

v. White Consolidated (1969). Both of these involved appeals regarding preliminary injunctions. In four cases brought by the government (Penick and Ford (1965), Northwest Industries (1969), ITT-Hartford (1969), and White Consolidated and White Motor (1971)) the final level of adjudication was at the District Court level where the issue was the granting of a preliminary injunction against a merger. In four other cases brought by the government, i.e., General Dynamics (1966), ITT-Grinnell (1970), ITT-Canteen (1971); and Airco (1974), the final level of adjudication was a trial on the merits of each case at the District Court level. In view of the variety of types and levels of judicial decisions it is difficult to derive a clear statement of the operative law on reciprocal dealing. Adding to the problems of interpretation is the fact that the government won both its appeal court and Supreme Court cases, but has fared poorly in the decisions on preliminary injunctions or in trial decisions on the merits of the case. The government was denied injunctions in three of the four cases and lost three of the four trials "on the merits" at the District Court level.

Returning to the matter of the consent decrees, our analysis indicates that 21 of the 34 decrees prohibit systematic reciprocal dealing in the form of trade relations activities citing Sections 1 and 2 of the Sherman Act. Four decrees cite only Section 1 and one cites only Section 2. Four decrees come under Section 7 of the Clayton Act and involve divestiture as well as prohibitions on reciprocal dealing. One decree relies on both Section 1 of the Sherman Act and Section 7 of the Clayton Act. All but two of the consent decrees were obtained by the Department of Justice. The other two were obtained by the FTC.[20] However, the FTC did obtain sever Assurances of Voluntary Compliance (AVC's) in 1968, 1969, and 1970 which the firms undertook to discontinue certain trade relations activities. In September 1970 the FTC announced it would stop accepting AVC's and would proceed under Section 5 of the Federal Trade Commission Act.

Of the 34 antireciprocity consent decrees obtained by the end of 1975, seven were obtained in 1970, ten in 1971, and eight in 1972. Three decrees were obtained in 1973 and four in 1974. From his analysis of the consent decrees, Farris indicates "basically two positive and immediate actions are specified,"[21] namely to cease all reciprocity relationships at once and to abolish trade relations units or other units performing a trade relations function. In addition, the firms agree in the future to:

--Refrain from communicating to actual or potential suppliers that preference in future purchases will be given based on sales to those suppliers;

--Stop compiling statistics by which sales and purchases can be compared--either for internal use or use by customers or suppliers;

--Prohibit cross information between sales and purchasing personnel;

--Prohibit the firm's executives from holding memberships in trade relations or similar associations involving reciprocal dealing; and

--Prepare a memorandum of the firm's policy on reciprocal buying to be circulated to all sales and purchasing personnel and to the firm's suppliers and customers.[22]

Consent decrees have one very important advantage to the firms involved. Once a consent decree is approved by the court, the firm cannot be sued for treble damages in a private action. Since private antitrust actions in the U.S. currently outnumber those launched by the government by almost twenty to one, it has been argued that they constitute a far more important deterrant than government actions.[23] Requests for treble damages for Sherman Act violations involving reciprocity were part of two cases mentioned earlier: Stavrides v. Mellon National Bank and Columbia Nitrogen v. Royster. It had been argued that "a settlement in the antitrust field is a good substitute for a decision only if the same purposes are achieved."[24] While the conduct complained of or the structural change precipitating the complaint may be enjoined or reversed, the consent decrees eliminated the opportunity for the clarification of the law relating to reciprocal dealing in particular and to conglomerate mergers in general. As we shall see the case law in these areas is thin, variegated, and ill-defined. Hughes argues that the task of interpreting the law fall to the judiciary. "On the other hand, the members of the executive branch of the government, particularly the Justice Department, are extremely political and are subject to the whim of those who appoint them to and remove them from office. Therefore, the executive branch seems to be the wrong decision-maker if separation of powers is to continue to exist."[25] With respect to the consent decrees in the three ITT cases, Professor Boyle is of the view that "the settlement accepted and the methods by which it was reached has probably tended to reduce even further the esteem which antitrust has in the mind of the general public. In effect, the approach used and the settlement reached have reduced a positive force for the efficient operation of our market society into a symbol of political corruption."[26]

## ANALYSIS OF THE CONTESTED CASES

We move now to a fairly detailed description and analysis of all of the major reciprocity cases which have been detailed between 1963 and 1975. Between 1937 when the California Packing case was decided, and 1963, when the FTC made the "trial" decision in the Consolidated Foods case, there were no contested cases which addressed the issue of reciprocal dealing. Therefore, we begin with that 1963 decision.

## FTC v. CONSOLIDATED FOODS CORPORATION

In April 1951 Consolidated Foods, a food processor, wholesaler, and retailer with sales of $174 million, acquired a small manufacturer of dehydrated onion and garlic, Gentry, Incorporated with sales of $2.6 million. Fourteen years later (and five and one-half years after the FTC launched its complaint) the Supreme Court of the United States declared that the acquisition violated Section 7 of the Clayton Act. The court held that, "Reciprocity in trading as a result of an acquisition violates [Section] 7, if the probability of a lessening of competition is shown"[27] By the end of 1975 this was the only antitrust case involving reciprocal dealing to be decided by the Supreme Court. A decade later, and after much analysis of and writing about the case,[28] it is still something of a conundrum.

### The FTC Decision (1963)

The FTC's complaint was laid in December 1957, two decades after the previous reciprocity case, California Packing (1937), was decided. In that case the FTC held that coercive reciprocity violated Section 5 of the Federal Trade Commission Act as being an unfair method of competition. The FTC's decision, written by Commissioner Elman, and made public on March 22, 1963, was the first on reciprocity in 26 years.

The essence of the FTC's complaint was this: "the utilization of Consolidated's purchasing power in such a manner as to coerce or attempt to coerce food suppliers to purchase dried food seasonings [onion and garlic] from its Gentry Division by withdrawing or threatening to withdraw its patronage"[29] resulted in a violation of Section 7 of the Clayton Act. In the hearing examiner's decision (December 29, 1961) eight specific instances of reciprocal dealing initiated by Gentry or its parent were cited.[30] In seven of these it seems apparent that the pressure by Consolidated did assist Gentry in making sales or making larger sales than it otherwise would have made as an independent firm. The hearing examiner concluded that "the competitive position or share of the market enjoyed by Gentry, under [Consolidated's] control, in the production and sale of dehydrated onion and garlic, has been enhanced to the detriment of actual and potential competition."[31] But the data on market shares are ambiguous, as Table 5 illustrates. Gentry's share of the dehydrated onion market increased from 27 percent in 1951 to 35 percent in 1958, while its share of the dehydrated onion market declined from 48 percent in 1951 to 39 percent in 1958. As the data show, the overall trends in market shares were subject to considerable year-to-year variation. For example, Gentry's share of the garlic market was 50 percent in 1952 (the first full year after it was acquired by Consolidated), changed to 43 percent in 1956, to 47 percent the next year, and then to 37 percent in 1958.

Commissioner Elman appeared to rely less on the market share data when he concluded:

> If reciprocal buying creates for Gentry a protected market, which others cannot penetrate despite superiority of price, quality, or service, competition is lessened whether or not Gentry can expand its market share.[32]

He went on to argue that the decline in Gentry's share of the garlic market does not prove the ineffectiveness of reciprocity: "We do not know that its share would not have fallen still farther, had it not been for the influence of reciprocal buying."[33]

TABLE 5

OUTPUT AND MARKET SHARES IN THE DEHYDRATED ONION AND GARLIC MARKETS, 1948-1958

| Calendar Year | Onion Total | Percentage of Total | | | | Garlic Total | Percentage of Total | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Basic | Gentry | Puccinelli | Simplot | | Basic | Gentry | Puccinelli |
| 1948 | 7,260,970 | 62 | 24 | 3 | 11 | 1,229,238 | No Data | No Data | No Data |
| 1949 | 5,533,646 | 55 | 31 | 9 | 5 | 1,486,028 | 39 | 53 | 8 |
| 1950 | 7,802,159 | 60 | 28 | 7 | 5 | 1,799,518 | 36 | 51 | 13 |
| 1951 | 13,621,343 | 59 | 27 | 5 | 9 | 2,027,906 | 41 | 48 | 11 |
| 1952 | 11,849,659 | 59 | 27 | 8 | 6 | 2,341,174 | 38 | 50 | 12 |
| 1953 | 11,736,010 | 52 | 36 | 7 | 5 | 2,614,114 | 44 | 47 | 9 |
| 1954 | 10,845,721 | 66 | 29 | 4 | 1 | 2,921,028 | 45 | 46 | 9 |
| 1955 | 13,701,517 | 57 | 29 | 8 | 6 | 3,877,186 | 46 | 44 | 10 |
| 1956 | 14,612,629 | 58 | 33 | 9 | - | 4,039,204 | 47 | 43 | 10 |
| 1957 | 17,036,961 | 52 | 38 | 10 | - | 4,516,871 | 42 | 47 | 11 |
| 1958 | 18,147,207 | 57 | 35 | 8 | - | 5,127,042 | 50 | 39 | 11 |

Notes:

1. Percentages rounded off to nearer whole. 2. Simplot did not produce dehydrated garlic.
3. Since Puccinelli data for 1948 is not available, the total for that year includes only Basic and Gentry.

Source: Consolidated Foods Corporation, Federal Trade Commission Decisions, Vol. 62, 1963, pp. 935-936.

At the heart of the FTC decision, and much of the subsequent debate, is the impact of reciprocal dealing on the competitors, actual and potential, of the firm able to use/offer reciprocal dealing. This is the foreclosure argument. Commissioner Elman put it this way:

> Here competition will be adversely affected if the reasonable likelihood arises that Gentry's competitors will be to some degree foreclosed by the Gentry-Consolidated merger from having the opportunity of selling to that portion of the market composed of Consolidated suppliers.[34]

To be in violation of Section 7, Elman pointed out, "the effect of the acquisition may be substantially to lessen competition". In the FTC decision, a three stage test was proposed:
(1) Is reciprocity anticompetitve in its effect? (2) If yes, did the acquisition transform the market structure "to create an environment conductive to anticompetitive reciprocity".
(3) If yes to (1) and (2) is the threat "sufficiently substantial" to be illegal under Section 7?[35]

Elman answered the first question in the affirmative by citing and discussing the three Section 5 Federal Trade Commission Act cases in the 1930's; Waugh Equipment, Mechanical Manufacturing, and California Packing. He concluded: "the vice of reciprocity... transforms substantial buying power into a weapon for 'denying competitors less favorably situated access to the market'. It distorts the focus of the trader by interposing between him and the traditional competitive factors of price, quality, and service an irrelevant and alien factor which is destructive of fair and free competition on the basis of merit."[36]

He also concluded that, "In many respects, reciprocal buying bears a close resemblance to the unlawful practice of entering into tying arrangements."[37]

With respect to the second question, Elman also concluded in the affirmative. He indicated that the acquisition of Gentry by Consolidated "presented it with an opportunity, previously unavailable, to reap a profit from sales in one product area, dehydrated onion and garlic, on the sheer strength of its buying power in other markets, and not on the basis of 'a better product or a lower price'."[38] In addition, Consolidated had overtly exercised its power with some degree of success. Further, he noted that Gentry's competitors were "ill-equipped to respond in kind."[39]

In terms of the development of judicial thought on reciprocity, Elman foreshadowed the concept of "reciprocity effect" when he stated:

> While [Consolidated] has admitted the overt exercise of the power inherent in its corporate structure, expressly conditioning purchases from processors on their purchases from Gentry, it seems clear that merely as a result of its connection with Consolidated, and without any action on the latter's part, Gentry would have an unfair advantage over competitors enabling it to make sales that otherwise might not have been made.[40]

Elman makes the same point in two other places in his opinion. First, in his definition of reciprocity when he speaks of firms overtly or "tacitly" making concessions [41] and second when he states that a food processor seeking to do business with Consolidated, and who also uses dehydrated onion and garlic, "will tend to prefer Gentry as his source of supply, and the advantages accruing to him from so favoring Gentry would not have to be pointed out by Consolidated." [42]

As to the third part of his test, the substantiality of the anticompetitive effect, Elman estimated that "firms that both supplied Consolidated and bought in volume from Gentry [10,000 lbs. of onion and garlic in any year from 1946 to 1958] purchased more than 25 percent of the onion produced by the industry and not quite 25 percent of the garlic."[43] He concluded that the area of prospective market foreclosure was "not merely significant, but exceptionally large" as "many other prospective purchasers from Gentry could be influenced by the expectation or promise of reciprocal purchases of their products by Consolidated."[44] As we shall see this point was challenged by Justice Stewart in his Supreme Court opinion.

Another facet of Commissioner Elman's opinion is important. He notes that in Section 7 cases the court is more concerned with the power conferred by changes in market structure than intent or actual conduct. The fact that Consolidated "has not chosen to systematize and vigorously enforce its reciprocal buying policy is of far less significance than that it obtained the <u>power</u> to do so by the merger...".[45] He pointed out the fact that the actual use of this power "demonstrated that [Consolidated's] possession of such power posed a real and substantial, and not merely abstract or theoreticaly, threat to competition."[46]

<u>The Appeal Court Decision (1964)</u>

The appeal court reversed the FTC decision (March 24, 1964) giving greater weight to the ten years of post-acquisition evidence saying, "the Commission has mistakenly rejected what the record demonstrates as to the past in favor of a future possibility based on conjecture and speculation."[47] In effect, the appeal court said that Consolidated has "done its damnedest"

and "no substantial impact on the relevant market occurred."[48] The court asserted that by eliminating the presence of wood splinters, Gentry has "achieved a product of higher quality than that of its competitors."[49] This finding would be challenged by the Supreme Court. With respect to Gentry's increased share of the onion market, the court argued that if it "were attributable to business reciprocity--implied or overt--it seems that it should have similarly affected Gentry's garlic business,"[50] which declined in terms of market share. The Court noted the rapid growth in the total market (see Table 5 on page 112) and the fact that Gentry's gain in its share of the onion market "when viewed in the light of the more significant loss of position with respect to dehydrated garlic indicates that reciprocity had no substantial impact...".[51] The Court also pointed out that by 1958 only 25 percent of Gentry's sales were to seven food processors who had "nationally known and advertised brands which through consumer acceptance and loyalty would be relatively immune from individual wholesaler or retailer dictation of the source from which ingredients must be obtained."[52] It was this point that formed the basis of Justice Stewart's Supreme Court opinion.

The Supreme Court Decision (1965)

In the Supreme Court decision, the opinion of the Court was delivered by Justice Douglas. Mr Justice Harlan concurred, with one exception, with the reasons as given by Justice Stewart. While concurring with the Court's decision to reverse the Court of Appeals and uphold the FTC decision, Mr. Justice Stewart's reasons appeared to challenge much of what Justice Douglas had relied on, and he based his decision on a point raised in the Appeal Court's decision. On only one point did all three Supreme Court judges agree, that the FTC decision should stand, i.e., that the merger violated Section 7 of the Clayton Act. Two of the three agreed that the Commission's finding was "barely supportable", to use the words of Justice Harlan.[53]

Justice Douglas' Opinion. At the very outset of his opinion Justice Douglas held that reciprocity made possible by the merger "is one of the congeries of anticompetitive practices at which the antitrust laws are aimed".[54] He quoted the FTC's conclusion that it is "'an irrelevant and alien factor' intruding into the choice among competing products...".[55] Justice Douglas also foreshadowed the "reciprocity effect" concept when he pointed out, "Reciprocal trading may ensue not from bludgeoning or coercion but from more subtle arrangements."[56] He ruled that "A threatened withdrawal of orders of products of an affiliate cease being bought, as well as a conditioning of future purchases on the receipt of orders for products of that affiliate is an anticompetitive practice."[57] Justice Douglas noted the change in Gentry's share of the garlic and onion markets, the doubling in size of the total market and the high level of concentration in both markets. He cited specific examples of ceteris paribus reciprocity. In reviewing the Court of

Appeal's decision, Justice Douglas indicated that it had given too much weight to the post-acquisition evidence. He stated:

> If the post-acquisition evidence were given conclusive weight or allowed to override all probabilities, the acquisition would go forward willy nilly, the parties biding their time until reciprocity was allowed fully to bloom.[58]

He argued that "the force of [Section] 7 is still in probability not in what later transpired...moreover, the post-acquisition evidence here tends to confirm, rather than cast doubt upon, the probable anticompetitive effect which the Commission found the merger would have." [59] Refuting what the Appeal Court said, Douglas stated, "The Commission found that Basic's [Gentry's major competitor---see Table 5 on page 112] product was superior to Gentry's--as Gentry's president freely and repeatedly admitted." [60] He continued, "Yet Gentry in a rapidly expanding market, was able to increase its share of onion sales by 7 percent and to hold its losses in garlic to a 12 percent decrease." [61]

Justice Douglas concluded his opinion by ruling that de minimus reciprocal dealing situations are beyond the reach of Section 7. "But where, as here, the acquisition is of a company that commands a substantial share of a market, a finding of probability of reciprocal buying by the Commission, whose expertise the Congress trusts, should be honored, if there is substantial evidence to support it." [62] He concluded that the evidence was "plainly substantial", for "reciprocity was tried over and again and it sometimes worked." [63] While he followed Commissioner Elman's opinion on point after point, Justice Douglas confuses a number of terms in his discussion. He speaks of "substantial evidence", "substantial share of a market", and "probability of reciprocal buying". The Commission focused on substantiality of the anticompetitive effect of reciprocity in terms of the share of market foreclosed to Gentry's competitors. For example, Gentry could have a substantial share of the onion or garlic markets and yet not be able to foreclose a substantial share of that market to its competitors if, as the Appeals Court pointed out, the buyers of dehydrated onion and garlic produce sufficiently well-recognized products that the threat of a major wholesaler/retailer to reduce or discontinue stocking them is of little consequence. It is one thing for Justice Douglas to rule that there is substantial evidence to sustain the FTC's decision and another for him to make his own finding of fact that in the case at hand "the effect of such acquisition may be substantially to lessen competition..." as provided in Section 7. He appears to have done both. In his decision Justice Harlan discusses this point.

> This Court must reveiw administrative findings as they are made by the agency concerned, and if the

> evidence will not support the findings and theory upon which the agency acted, an affirmance of the agency's order cannot properly rest upon a reassessment of the record by us.[64]

Specifically, Harlan did not want to rest an opinion on "evidence upon which the commission indicated no reliance."[65] He found that the seven instances of successful efforts by Consolidated to pressure its suppliers to buy from Gentry, "for the Commission justifiably to find that Consolidated had not used all the reciprocal buying leverage it could muster", and therefore, that the "probable effect of Gentry acquisition would be substantially to lessen competition in the relevant market".[66]

Justice Stewart's Opinion. We move now to Justice Stewart's opinion, in many ways the most interesting of the three. At the outset he ruled that Section 7 was not passed to outlaw diversification and that "clearly the opportunity for reciprocity is not alone enough to invalidate a merger...".[67] More than the "bare potential" for reciprocal buying", the law requires a more closely textured economic analysis."[68] He goes further to point out that "the mere effort at reciprocity cannot be the basis for finding the probability of a significant alteration in the market structure. Section 7 does not punish intent." From the point of view of economic theory, opportunity for reciprocity as such is not a recognized element of market structure. However, one of the bases for reciprocal dealing, monopsony power, is one element of what economists refer to as market structure.[69]

Since opportunity is not enough Justice Stewart states that "some standard must be established for determining how effective reciprocity must be before the merger is subject to invalidation."[70] On reviewing the effects of the merger he finds that "the industry reflected the salutary qualities normally associated with free competition."[71] In particular the merger may have spurred technological innovation and the improvement of product quality. Justice Stewart states, "there is no evidence to indicate that barriers to entry were particularly severe."[72] The Appeal Court had pointed out that a small producer of dehydrated onion, Simplot, left that industry in 1955 "for reasons having no bearing on the issues here",[73] and that Gilroy Foods had entered both the onion and garlic industries in 1959. This firm was later acquired by McCormick Foods Inc., "whose requirements exceed Gilroy's output."[74] The Appeal Court also noted that in 1961 a subsidiary of General Foods announced plans to build a plant to make dehydrated onions, scheduled for completion in late 1961.[75]

Justice Stewart specifically rejected the FTC's finding, followed by Justice Douglas, "that processors seeking a second source of supply relied on Gentry rather than Puccinelli [see Table 5, page 112]. That fact can rest on so many alternative hypotheses that it is persuasive as to none."[76]

In a Section 7 case, Justice Stewart stated, "the touchstone ...is the probability that competition will be lessened."[77] We note that the statute speaks of "the effect of such acquisition may be substantially to lessen competition...." He went on to say that, "To determine that probability the courts and the Commission should rely on the best information available, whether it is an examination of the market structure before the merger has taken place, or facts concerning changes in the market after the merger has been consummated."[78] He chided the Court of Appeals, not for giving too much weight to the post-acquisition evidence, but for "the gloss it placed on the statistics and testimony adduced before the hearing examiner and the Commission."[79]

Having advocated "a more closely textured economic analysis," Justice Stewart found "the record in this case sorely incomplete, and a reviewing court is given little guidance in determining why this merger should be voided, if reciprocity--creating mergers are not per se invalid."[80] He concludes that "the record contains just enough [evidence] to support invalidation of the merger, but because of evidence not referred to in the Court's [Mr. Justice Douglas'] opinion."[81] His argument is that the food processing industry is composed of two classes of manufacturers: those with "significant brand names commanding consumer acceptance" and "the smaller processors," many of whom "sell their product to Consolidated in bulk, for packaging under house labels of Consolidated divisions."[82] Consolidated's power over the brand name manufacturers "is minimal" while the other manufacturers who rely on wholesalers like Consolidated to persuade supermarkets to stock their lesser known labels "are susceptible to the subtle pressures of reciprocity."[83] Justice Stewart concluded that "the pattern of movement in this class, when contrasted to the lack of a pattern among the major processors, seems to me sufficient to support the Commission's conclusion that these shifts were in response to the influence of reciprocity, whether express or 'tacitly accommodative.'"[84] He added that this pattern confirms that Consolidated has the power to influence the purchases of a substantial segment of its suppliers.

## Analysis of the Opinions

Quantitatively, what share of the relevant market must be "foreclosed" by reciprocal dealing before the merger giving rise to the reciprocity is declared in violation of Section 7? The FTC ruled that at least one-quarter of the markets for dehydrated onion and garlic was foreclosed and described this fraction as "not merely significant, but exceptionally large"[85] Mr. Justice Douglas affirmed the FTC's reasoning and decision. Mr. Justice Stewart gave no quantitative measure, but our inferences from his analysis and data provided by the FTC and the appeal court decision is that foreclosure of about 15 percent of the market by reciprocal dealing will make the merger illegal under Section 7.

Consider the data in Table 6.

TABLE 6

CONSOLIDATED FOODS CASE: ESTIMATES OF MARKET SHARES

| | Gentry's 1958 Sales (millions of lbs.) Dehydrated Onion | Dehydrated Garlic |
|---|---|---|
| (1) Total industry sales | 18.147 | 5.127 |
| (2) Gentry total sales | 6.259 | 1.980 |
| (3) Gentry sales to major customers of Consolidated | 4.617 | 1.264 |
| (4) Gentry sales to 7 manufacturers with nationally known and advertised brands | 1.600 | .500 |
| (5) Gentry's sales to major customers of Consolidated other than (4), i.e., (3)-(4) | 3.017 | 1.480 |
| (6) Share of total market foreclosed: | | |
| (a) FTC and Justice Douglas | (3)÷(1)=25%+ | (3)÷(1)=25%+ |
| (b) Mr. Justice Stewart (as derived from his argument) | (5)÷(1)=16.6% | (5)÷(1)=14.9% |

SOURCES: (1) and (2) Federal Trade Commission Decisions, Vol. 62, 1963, pp. 935-936; (3) Ibid., p. 957; (4) Federal Reporter, 2d Series, Vol. 329, 1964, p. 627. The Appeal Court indicates that "only 25 percent of Gentry's sales" were to these national manufacturers. Therefore (4) was taken to be .25 Gentry's total sales.

It would appear that two significantly different quantitative standards were developed in the only Supreme Court ruling on reciprocal dealing. If foreclosure of one-quarter of the market was more than enough for the FTC and Justice Douglas, was foreclosure of one-sixth sufficient, the proportion implied by Justice Stewart? On May 30, 1968 the Justice Department issued its "Merger Guidelines" in which it stated:

> Unless it clearly appears that some special market factor makes remote the possibility that reciprocal buying behavior will actually occur, the Department considers that a significant danger of reciprocal buying is present whenever approximately 15 percent or more of the total purchases in a market in which one of the merging firms ("the selling firm") sells are accounted for by firms which also make substantial sales in markets where the other merging firm ("the buying firm") is both a

substantial buyer and a more substantial buyer than all or most of the competitors of the selling firm.[86]

From this statement one wonders the extent to which the quantitative standard implied by Mr. Justice Stewart in Consolidated Foods influenced the determination of the 15 percent figure. Writing before the Supreme Court's decision was announced, Professor Donald F. Turner, later Assistant Attorney General for the Antitrust Division, argued that "a conglomerate merger should not be outlawed because of possible reciprocity effects unless at least fifteen or twenty percent of a market is made subject to foreclosure."[87] He agreed with the Appeal Court's reversal "because of the lack of any indication that Consolidated had leverage over purchasers who accounted for a substantial share of the dehydrated onion and garlic markets."[88] Professor Hinnegan argues that "the evidence does not support a finding of a probable, substantial lessening of competition at all" and he is "forced to conclude that the Commission and the Court were satisfied with something less because they proscribed the merger."[89] He pointed out that Consolidated could not "pressure" national suppliers with widely accepted brand names to purchase from Gentry and that such packers' sales to Consolidated in most cases were less than one percent of their total sales. He states, "better than eighty percent of Consolidated purchases came from this type of supplier. Further, the record shows that, for various business reasons, even the private label packers were not susceptible to reciprocity pressures."[90] Hinnegan concludes that "the evidence shows that any results realized by (Consolidated's attempts at reciprocal dealing) were strictly de minimus at best."[91] He goes on to note that Consolidated called witnesses from about twenty-five representative Gentry customers "who unequivocally denied that their sales to Consolidated had any connection with their purchases from Gentry. They testified in detail and repeatedly to very real reasons why reciprocity cannot be an effective market force in the food industry."[92] Hinnegan questions why this testimony was not accepted by the Commission or the Court--"unless purchasing agents, as well as trade relations men, are considered to be morally or ethically questionable in their methods of dealing."[93] We might add that in subsequent cases the courts did accept such testimony.

## U.S. V. INGERSOLL-RAND (1963)[94]

### The Preliminary Injunction

Less than three weeks after the FTC had given its opinion in the Consolidated Foods case, District Court Judge Rosenberg granted the Justice Department an interlocutory injunction against the acquisition of three manufacturers of underground coal mining machinery by the Ingersoll-Rand Company, a large maker of general industrial machinery. In 1961 I-R had sales of $181 million.

Very early in his opinion Judge Rosenberg made it plain it was not his intention to consider the evidence presented before him in five days of trial "as finalizing the case, but only in such character as to guide [him] into making a preliminary determination."[95] His opinion rests on two main points: (1) that the combination of three manufacturers of underground coal mining machinery and equipment will increase the level of concentration in the line(s) of commerce involved and so violate Section 7 of the Clayton Act, and (2) that the acquisitions "may contravene the provisions of Section 7 if they result in the creation of relationships between the resulting company and its customers and suppliers which may bring about competitive advantages to the merging companies detrimental to competition,"[96] i.e., reciprocal dealing. Some five pages of the decision are devoted directly to (1) and only one page is devoted to (2). The judge finds that the acquisitions would give I-R 30 percent of "the broadest relevant market, underground coal mining machinery and equipment,"[97] 60 percent of the total industry sales of continuous miners (the narrowest relevant market), and "about forty percent of the total industry sales in face coal mining machinery and equipment,"[98] the intermediate market definition.

Judge Rosenberg's analysis of reciprocity is based on alleged <u>three-way</u> reciprocal dealing, and no figures are presented.

> Ingersoll-Rand's position as the fourth largest general industrial machinery manufacturer requires it to purchase large quantities of steel, and its purchases are important to the steel industry. The steel industry, on the other hand, constitutes one of the largest markets for coal today. It is not overly speculative to assume that the judicious use of its steel-purchasing power by Ingersoll-Rand could immeasurably increase the sales by the acquired companies of machinery and equipment to the coal mining companies which acutely need the goodwill of the steel industry.[99]

Not content with this long series of unsupported inferences the judge also asserts, here outlining the concept of what was later called "reciprocity effect," that the overt exercise of such power (even in three-way reciprocity!) may be unnecessary:

> Moreover, the mere existence of this purchasing power might make its conscious employment toward this end unnecessary; the possession of the power is frequently sufficient, as sophisticated businessmen are quick to see the advantages in securing the goodwill of the possessor.[100]

Judge Rosenberg followed the Supreme Court's dictum in <u>U.S. v. Griffith</u> (1949) (also followed by the FTC in <u>Consolidated Foods</u>) that large-scale buying power can be a weapon for "denying competitors less favorably situated access to the market."[101]

His condemnation of reciprocal dealing as "an irrelevant and alien fact which is destructive to fair and free competition on the basis of merit"[102] follows directly the language of Commissioner Elman,[103] but without the benefit of proper citation.

## Appeal on the Preliminary Injunction

This decision, which was upheld by the Court of Appeals for the Third Circuit, illustrates the problem when judges go farther than they need to justify their decision. The reciprocity arguments were superfluous in this case because the horizontal combination aspect was so strong. Data presented in the appeal court decision indicated that the three proposed acquisitions jointly accounted for the following market shares:[104]

| Market | Share of market (range) 1960-1962 |
|---|---|
| Continuous miners (narrowest definition) | 60.7% - 63.2% in dollar value<br>53.9% - 60.3% in machines sold |
| Face coal mining machinery and equipment | 38.4% - 47.9% in dollar value |
| Underground coal mining machinery and equipment (broadest definition) | 29.7% - 32.5% in dollar value |

The appeal court agreed with Judge Rosenberg's finding of fact that "The company [Ingersoll-Rand] putting these units together will, with their financial resources, and with the finance company which Ingersoll-Rand already has established, tend to create a monopoly by elimination of competition by other companies in this line of commerce."[105] On the matter of reciprocity, the appeal court quoted with approval the words of Judge Rosenberg that we cited above and concluded, "We think it has been demonstrated clearly that the public interest required the interlocutory relief granted by the court below."[106]

## Analysis of Ingersoll-Rand

The lack of even the most elementary analysis of the potential profitability of reciprocity is obvious. In 1961 I-R had sales of \$181 million and its steel purchases could not have exceeded \$40 million. Using the broadest market definition, the sales of the three firms to be acquired was \$13 million out of a total of \$41.7 million in 1962. Suppose, through <u>three-way</u> reciprocity I-R could increase its share of the market to one-half, i.e., about \$21 million in sales. Suppose further that the net profit before tax on the increase amounted to 25 percent of sales (a very generous estimate). Then I-R would increase its net profits by \$2 million. What is the basis for this most optimistic result? It is that I-R is a sufficiently important purchaser of steel that it can pressure its steel suppliers to pressure their

coal suppliers to purchase their underground coal mining machinery and equipment from I-R's new subsidiaries. But almost one-half the coal mined does not come from underground operations and one-quarter of all coal is not sold to industrial users. While no figures are available, it is likely that energy utilities consume more coal than do steelmakers. In any event, the $40 million in steel purchases we estimated for I-R is not large relative to the total output of any of the major steel makers.[107] If I-R really had unexploited monopsony power, it could increase its net profits before taxes by $2 million by reducing the price paid for its steel by 5 percent. It is hard to imagine I-R had sufficient unused market power to be able to practice such secondary reciprocity or that if it did why it would not use it directly by obtaining steel at lower prices.

U.S. V. PENICK & FORD LTD. (1965)

This case is the result of a request by the Justice Department for a preliminary injunction preventing the R. J. Reynolds Tobacco Co. from acquiring Penick & Ford, the fourth largest producer of cornstarch and related products.[108] The Government based its claim (under Section 7 of the Clayton Act) largely on the contention that competition in the sale of starch and dextrin for use as an adhesive in the corrugated box and paper industry would be impaired because of the potential for reciprocity between Reynolds, a large user of boxes and paper, and its suppliers of these materials, to the benefit of Reynolds' affiliate Penick & Ford. District Court Judge Coolahan denied the injunction describing the Government's case as "mere speculation inferred from a state of facts ambiguously conducive to such conjecture."[109] He concluded there had "not been a sufficient showing that the acquisition will create the probability of a protected market in the [starch] industry which cannot be penetrated by competing firms, and more particularly that Reynolds would engage in or encourage the type of practice prohibited [reciprocity]."[110] The decision was given just three weeks after the Supreme Court's ruling in the Consolidated Foods case to which Judge Coolahan repeatedly referred, but was at pains to distinguish from the facts in Penick & Ford.

The Judge began by discussing a number of facts about the cornstarch-dextrin industry. The industry had ten producers and two nonproducers who bought for resale. Total output was expanding. As the fourth largest producer, Penick & Ford (P & F) accounted for 12.8 percent of the market if imports (10 percent of the total) and the output of one firm are ignored. Therefore, P & F probably had about 11 percent of total U.S. sales of starch if we adjust for these two factors. The largest single use of starch was as an adhesive in the corrugated box and paper industry. Judge Coolahan said the evidence established that "the starch producers and the paper company consumers engage in the practice

of trade relations which fosters reciprocity."[111] While reciprocity was "a definite industry factor," it was often practiced defensively, there was "great emphasis on research and sales techniques," and reciprocity was "not so significant a factor as to preclude competition where other competitive means are not equivalent."[112] The Judge accepted the Government's argument that the "particular sub-line of commerce" affected by the acquisition was the sale of cornstarch to the paper industry.[113] He described the industry as made up of "ten viable, aggressive competitors none of which clearly dominates the entire market."[114] He noted that a new entrant in three and one-half years "through the use of more efficient production means was able to effectively engage in price competition and swiftly move to the lead of industry."[115] In short, Judge Coolahan found that while members of the industry engaged in reciprocity, the structural preconditions of the industry militated against it becoming a significant factor in an industry in which "competition flourishes."[116]

These findings were reinforced by his findings on the evidence regarding Reynolds. Judge Coolahan gave the greatest weight to the fact that "there has been no policy of reciprocity practiced either currently or in the past. The purchasing and sales departments are unrelated and under the control of different executives."[117] He went on to point out, "At no time did the Government show or introduce proof that Reynolds had ever deviated from this nonreciprocal policy either in its own business or in the business of the concerns acquired under its diversification program."[118] But like Judge Rosenberg, Judge Coolahan had occasion to prove too much. For example, he observed that "Reynolds' motives for acquisition are manifestly aimed at diversification rather than efforts to obtain leverage in the starch industry."[119] While following Justice Stewart on the point that, "the opportunity for reciprocity is not alone enough to invalidate a merger under [Section] 7," he ignored Stewart's ruling that "Section 7 does not punish intent." Similarly, Judge Coolahan expended some effort in pointing out the irrationality of Reynolds' deviating from its policy of strict cost control of its purchases --"it would seem poor economic judgment to jeopardize such successful business policy in order to increase the sales of a newly acquired subsidiary, especially where the increase will only be a small percentage of that subsidiary's entire gross business."[120] The last two arguments are superfluous to his other findings of fact. In seeking to "gild the lily" he is leaving himself open to attack for trying to prove too much.

In arriving at his decision Judge Coolahan set out the following test:

> ...the Government must prove by clear and convincing evidence that the transaction sought to be prohibited will have a probably substantial anticompetitive effect.[121]

Because this was a hearing upon an application for a preliminary

injunction, the Government must establish that it has a "reasonable probability of success in proving their case on the merits upon a final hearing."[122] in applying the Supreme Court's decision in Consolidated Foods, Judge Coolahan argued that "while that decision lends support for the underlying theory many factual distinctions exist between the two cases."[123] In this regard he compared the level of concentration, whether or not the acquiring firm assisted or was likely to assist in reciprocal dealing, the availability of post-acquisition evidence and the extent to which the Government could obtain alternative relief in the future.[124]

In conclusion, Judge Coolahan found that the "evil" had existed prior to the proposed acquisition and that while the entrance of Reynolds presented the possibility of increasing reciprocity by purchasing power, possibility is not probability and the Government had not met the test of Section 7.[125]

The Justice Department, undaunted by this decision, brought a civil suit alleging violation of both Section 7 and Section 1 of the Sherman Act requesting that Reynolds divest itself of Penick & Ford. On September 22, 1969 a consent decree was entered, also before Judge Coolahan, in which Reynolds was required to sell off Penick & Ford within two years.[126]

U.S. v GENERAL DYNAMICS
(1966)[127]

In a decision that was not appealed, District Court Judge Canella ruled that General Dynamics Corporation's acquisition of The Liquid Carbonic Corporation in 1957 violated both Section 7 of the Clayton Act and Section 1 of the Sherman Act.[128] However, the Government failed to prove that Liquid Carbonic's efforts at systematic reciprocity, as assisted by General Dynamics, resulted in contracts (bilateral agreements) in restraint of trade of a "not insubstantial amount" of commerce, and as such, violated Section 1.

Review of the Findings
of Fact

We begin by reviewing some of the facts of the merger brought out in the decision. When GD acquired LC in 1957 it had sales of $1.5 billion and was among the 20 largest industrial corporations in the U.S. In 1956 LC had sales of $35 million, a little over half of which came from carbon dioxide ($CO_2$). However, LC was the largest producer of $CO_2$ (solid, liquid and gas) having 35 percent to 40 percent of a market in which the two largest firms had 60 percent, the four largest 75 percent and the six largest 79 percent of total sales. By 1961, the year before the Government launched its complaint, GD had sales of over $2 billion and 75 to 85 percent of these were to the armed forces, AEC and NASA. Because of this fact it was asserted that GD had considerable unexploited monopsony power which could be effectively utilized by LC through reciprocal dealing with GD's suppliers.

Judge Canella reviewed the intent of both GD and LC in entering into the merger. He concluded that, "Liquid Carbonic con-

sidered the opportunities for reciprocity as its most significant advantage to be derived from the merger. General Dynamics, on the other hand, although aware of the market power created by the merger and at least passively assenting to aid the implementation of [reciprocity]..., was primarily motivated to merger by a desire for diversification."[129] On the matter of intent in Section 7 cases, Judge Canella indicated he was following the Supreme Court's dictum in Brown Shoe (1962) that intent "is an aid in predicting the probable future conduct of the parties and thus the probable effects of the merger."[130]

Reciprocal dealing by GD and LC was of the highly systematic type. Very shortly after the merger, top level executives of both created the "Special Sales Program." Its two main features consisted of (a) the preparation of data on the major suppliers of GD who could also purchase LC's outputs, and (b) contacting the "target" companies' top level management by persons similarly placed in GD. "Prospect cards," "sales reports," a "regional card index system" and "vendor books" listing 4,000 suppliers whose sales to GD in 1958 exceeded $10,000 were utilized. In the spring of 1961 the program was refined with the addition of the "National Accounts System." "This group of accounts consisted of approximately 350 companies each of which sold $250,000 of goods in 1960 to General Dynamics."[131] GD and LC's efforts were further focused on firms in which purchasing was controlled at headquarters rather than at the individual operating units. The judge remarked, "It was feared that pressure applied directly to purchasing agents, whose jobs are too limited to appreciate the 'mutual benefits' of reciprocity, could lead to complaints to the Anti-trust Division of the Justice Department."[132]

While the odd exception was noted, most of the reciprocity was of the ceteris paribus type--if LC could match the terms of its competitors, it would automatically obtain the business. In this case the form of reciprocity was akin to what we have earlier described as the "negative psychological type," except that the initiative came from GD-LC. The judge described it as follows:

> In the normal course of events an account which cooperated merely continued to receive its share of sales to General Dynamics, i.e., the status quo was maintained. No affirmative promises of favorable treatment were made.[133]

Judge Canella rejected GD's claim that its purchases were made on the basis of open bids--hence it could not threaten to curtail purchases. He asked, if this was true, why had GD created its reciprocity program? He then noted that GD under the Defense Department regulations could determine which firms were invited to bid and could tailor the specifications to fit cooperative suppliers.[134] He also rejected the claim that lack of interdivisional cooperation in GC prevented the Special Sales Program from operating effectively.

What impact did GD-LC's systematic program of reciprocity have? Between 1960 and 1962, Judge Canella found that sales of $CO_2$ to SSP accounts increased from $3,189,325 to $3,542,888, and sales of other industrial gases to SSP accounts increased from $2,728,816 to $4,346,455. He gave particular weight to the fact that total sales by LC to the SSP accounts increased by 33 percent while total gas sales, including the reciprocity accounts, increased by only 7 percent. "The court finds that the relevant causal factor is the use of reciprocity."[135] The judge noted that the 2.7 percentage point decline in LC's market share in the period 1954-57 "was effectively halted...Between 1957 and 1962, its share of the combined sales [of the 6 largest $CO_2$ distributors] increased from 33.6 percent to 36.1 percent, as measured in tons shipped, and from 36.2 percent to 37.5 percent in dollar amounts."[136]

## The Judge's Findings on the Law

The merger of General Dynamics and Liquid Carbonic came before the court under Section 7 of the Clayton Act, "because it created an opportunity for the defendant to increase sales via the use of reciprocity."[137] Judge Canella cited the words of Corwin Edwards, Commissioner Elman and Justice Douglas in making the point that "'reciprocity' is not a word of fixed meaning."[138] He introduced the concept of "mutual patronage" reciprocity to judicial opinion, which "occurs when both parties stand on equal footing with reference to purchasing power _inter se_, yet agree to purchase from one another."[139] He emphasized Justice Douglas' point that "reciprocal dealing may ensue not from bludgeoning or coercion but from more subtle arrangements" and Edward's relating to "large and powerful concerns" exchanging favors. He concluded that "a prohibition of coercive and noncoercive reciprocity practices is no more restrictive than the present checks on, _inter alia_, horizontal and vertical mergers and requirements contracts. When a sufficient volume of trade is concerned, a balancing of interests requires that the businessman's freedom of operation must be curtailed to prevent concentration of economic power inimical to the public interest."[140] Judge Canella held that both coercive and mutual patronage reciprocity are anticompetitive practices.[141]

With respect to Section 7, the judge, following _Consolidated Foods_, stated, "the question is whether the reciprocity made possible by the merger gives rise to the probability that a substantial lessening of competition will occur."[142] To answer this question Judge Canella argued that the merger gave GD an outlet for its purchasing power to create sales via reciprocity through its LC subsidiary. In particular, he focused on the use of leverage by GD, i.e., where a supplier's sales to GD were many times larger than LC's sales of $CO_2$ and industrial gases to the supplier. In such cases "a distinct [and] a predictable threat to competition is presented."[143] As to whether such leverage will be used,

he concluded, "the practice being prevalent in the business community, its implementation can be expected."[144] We note that no empirical evidence was cited to support this statement. But the judge did point out that Liquid Carbonic had "a long history of antitrust violations."[145] Like Commissioner Elman, he emphasized the large firm's power to engage in coercive reciprocity.

The issue of whether competition was substantially lessened was held to rest on the amount of foreclosure which the defendant's activities could be expected to achieve if unchecked.[146] Judge Canella focused on the sales of $CO_2$ to 359 firms considered by the government as major accounts and targets for systematic reciprocity. In 1962 such sales ($2,542,888) accounted for 17.4 percent of LC's total $CO_2$ sales, 6.6 percent of the top 6 firms' $CO_2$ sales and 5.2 percent of all $CO_2$ distributors' sales. The judge held that "while certainly not every sale in the $3,542,888 total was made, or assured, by the presence of reciprocity, the figure does indicate, in a rough fashion, the dimensions of the potential involved. Moreover, it should be mentioned that the 1962 sales figure represents the actual, not the potential, sales to major accounts."[147] Although he did not expect the potential to rise to the 25 percent figure in Consolidated Foods, "it certainly would far exceed the 5 percent figure for the program at that time was still in its infancy."[148] Judge Canella, in adopting the 5 percent figure for purposes of discussion, describes it as, "the most conservative estimate of the probably foreclosure possible under the circumstances."[149] He then noted that in the Alcoa (Rome Cable) (1964) and the Brown Shoe (1962) cases the Supreme Court had enunciated the rule that the higher the level of market concentration, the more suspect a given amount of foreclosure becomes.[150] The judge then reviewed the Philadelphia National Bank (1963) case where a horizontal merger accounting for 30 percent of the market and the Alcoa (Rome Cable) case in which only 1.3 percent of the market was added to the defendant's control. In both cases the Supreme Court held that the mergers violated Section 7.

## Analysis of the Anticompetitive Effect

Unfortunately, Judge Canella confused an increase in market concentration and the amount of the market foreclosed. If we measure the level of concentration by the share of the market controlled jointly by the four largest firms, an increase in LC's share by five percentage points may not change the four-firm concentration ratio at all. Only if all of LC's increased share of the market (e.g., from 35 to 40 percent) comes at the expense of many small firms (firm No. 5 or smaller), will the four-firm concentration ratio increase. But it is far more likely that LC's increase will come at the expense of proportionate decreases in the market shares of the larger firms.

In this case, LC's share increases but concentration, as measured by the four-firm concentration ratio, is unchanged. Unlike a straight forward horizontal merger, as in the cases cited by Judge Canella, "foreclosure" by LC of 5 percent of the market does not reduce the number of competitors. It merely redistributes market shares.

Since he used a different concept of foreclosure than was used by Commissioner Elman and Justice Stewart in the Consolidated Foods case, can we use the data provided in Judge Canella's decision to measure the extent of foreclosure due to reciprocity in the $CO_2$ market? Early in 1961 a senior executive in charge of reciprocity is quoted as saying that the special Sales Program "used properly, patiently, and effectively could easily generate 5 million dollars in new business over the next two years."[151] In his footnote to this statement Judge Canella points out that the dollar estimates included both $CO_2$ and industrial gases whose sales were about equal in 1960-62.[152] LC's sales of $CO_2$ to the SSP accounts totalled just over \$3.5 million or 5.2 percent of the total $CO_2$ market. To this \$3.5 million figure, which the judge admitted included sales to national accounts not attributable to reciprocity, let us add the \$5 million estimated increase in sales due to reciprocity and assume all such sales were of $CO_2$, then divide by total industry $CO_2$ sales in 1962 (\$68.3 million) we find that the outside estimate of the market foreclosed is 12.4 percent. If we assume one-half the total increase in sales due to reciprocity was accounted for by $CO_2$, then the market foreclosed amounted to $(3.5+2.5)\div 68.3=8.8\%$ of sales. Mr. Justice Stewart in Consolidated Foods apparently found 15 to 17 percent of the marked foreclosed as "barely supportable" as a substantial lessening of competition. We have shown that at the outside the share of the $CO_2$ market foreclosed was 12.4 percent (but probably 8.8 percent). Had Judge Canella not embarked on a line of reasoning using the market share tests in horizontal merger cases, to which the Supreme Court itself did not refer, he could not have arrived at his decision. In light of the market share implicit in Justice Stewart's analysis, Judge Canella would have had to rule that General Dynamics use of reciprocity on behalf of its affiliate Liquid Carbonics had not foreclosed a proportion of the $CO_2$ market sufficient to result in a substantial lessening of competition.

Our discussion of Judge Canella's decision as it relates to the charge under Section 1 of the Sherman Act will be conducted under the section "The Sherman Act Cases" below.

ALLIS-CHALMERS MFG. CO.
V. WHITE CONSOLIDATED
INDUSTRIES INC. (1969)[153]

## Preliminary Injunction

Late in 1968 White Consolidated (WC), a conglomerate firm with sales of $825 million, moved to acquire Allis-Chalmers (A-C), a diversified manufacturing enterprise with sales of $821 million. In 1965 WC's sales totalled only $54.7 million, although it had acquired 20 firms since 1950. Between 1966 and 1968 WC acquired another 12 firms including Blaw-Knox, a manufacturer of rolling mills which was to figure in the alleged opportunity for reciprocal dealing. A-C sought a preliminary injunction preventing WC from making a tender offer to increase its share ownership from the 31.2 percent it has purchased from Gulf and Western Industries. District Court Judge Wright refused to grant the preliminary injunction. He argued that A-C failed to establish that the merger would prevent potential competition in the form of the likely entry of A-C into the electrical appliance and metal rolling mill industries.[154] In addition, he ruled that A-C failed to establish a loss of potential competition in "larger custom machine shop capability," where A-C claimed to have 15 percent of national capacity and WC to have 5 percent. Judge Wright ruled that "large custom machine shop capability" was not a product or line of commerce and that there was insufficient evidence to establish a reasonable probability of success if the case was tried on its merits.[155] It is important to note that no mention of reciprocity was made in the District Court's opinion.

## Appeal on the Preliminary Injunction

The Court of Appeals for the Third Circuit reversed the District Court in a two-to-one decision, holding that there was a reasonable probability of showing a violation of Section 7 of the Clayton Act on a final hearing.[156] Circuit Judge Stahl, writing the majority opinion, the decision in which Seitz C.J. concurred, directed his opinion to three issues. He stated:

> ...the proposed acquisition of Allis by White poses the probability of a violation [of Section 7]...because the acquisition threatens to:
>
> (a) eliminate potential competition in the metal rolling mill industry and other relevant markets;
>
> (b) diminish potential independent competition in other diversified markets; and
>
> (c) enhance the power of a White-Allis to engage in reciprocal dealing.[157]

While Judge Stahl dealt with three issues, Judge Seitz, following Judge Rosenberg in Ingersoll-Rand, was prepared to grant a preliminary injunction solely "on the ground that after final hearing the district court might find that the merger would create a market structure conducive to unlawful reciprocal dealing in the rolling mills area."[158]

In evaluating the opinions expressed in this case and in Penick and Ford, Ingersoll-Rand, Northwest Industries, ITT-Hartford, and White Consolidated and White Motor we must keep in mind that they are opinions regarding applications for a preliminary injunction. This is in contrast to Consolidated Foods, which was a trial on the merits of the case with eventual appeal to the Supreme Court. Judge Stahl points out "nothing said in this opinion is to be taken as an attempt to determine finally any aspect of the ultimate merits of this case."[159] Many commentators, and even some of the judges, move back and forth between the various opinions without regard to the context in which they were written. Yet presumably both the quality of the evidence and the standards of proof are different in a hearing on a preliminary injunction, in an appeal on a preliminary injunction (which is to rule only on whether the lower court has abused its discretion in granting or failing to grant a preliminary injunction,[160] and in a proper trial on the merits of the case.

We will now examine Judge Stahl's majority opinion in the Allis-Chalmers case solely as it relates to reciprocity. Then we will look at Judge Seitz's concurring opinion. Judge Stahl noted that the major purchasers of rolling mills are the steel companies, that A-C purchased an average of $30 million worth of steel from the ten steel companies which are Blaw-Knox's (a subsidiary of White) principal customers for its rolling mills, and that A-C's total annual purchases of steel mill products totalled $44 million. He then went on to say, "When coupled with White's annual purchases of steel mill products, about $42,000,000 in value, a White-Allis combination would buy a far larger amount of steel than any of Blaw-Knox's competitors in the rolling mill market."[161] From this fairly straightforward recital of facts, the judge proceeded to draw a strong conclusion: "The danger to competition inherent in that market situation is not difficult to perceive."[162] Judge Stahl then cited Justice Douglas' point that reciprocal dealing need not ensue from "bludgeoning and coercion," and the similar point made by Judge Rosenberg in Ingersoll-Rand regarding "the mere existence of this purchasing power...." He concluded that "the tremendous purchasing power of a White-Allis combine, coupled with Blaw-Knox's enhanced position in the rolling mill market, may foreclose White's competitors in the sale of rolling mill machinery to the steel industry."[163] We note that the double effect here is really a single effect, as it is the purchasing power of the White-Allis merger which gives Blaw-Knox its "enhanced position."

But far more important is the complete lack of empirical evidence (or analysis) to buttress this conclusion--specifically to determine if the extent of market foreclosure is sufficient that it "may be substantially to lessen competition" as provided in Section 7. Like Judge Rosenberg in Ingersoll-Rand, Judge Stahl saw no need to enter into an analysis of market shares

either with respect to reciprocity or the horizontal and vertical aspects of the merger. He stated, "I do not believe the question of market shares is dispositive in the present preliminary stage of the proceedings," particularly in a conglomerate merger situation.[164] He viewed Section 7 as "designed to arrest the rising tide of economic concentration and to curb, in its incipiency, a lessening of competition made probable by the possession of market power acquired via corporate acquisitions within the scope of [Section] 7."[165] Judge Stahl saw the potential for reciprocity as promoting the "entrenchment of already significant market power" and therefore an anticompetitive factor. At no time in his entire opinion does the judge address the issue of whether the anticompetitive effects "may be substantially to lessen competition." He simply rules "that the proposed takeover is very likely to have anticompetitive effects in violation of [Section] 7."[166] Judge Seitz based his entire concurring opinion on the reciprocity aspect of the case. He specifically rejected White's argument that Allis' purchases of steel ($30 million a year) from the principal customers of Blaw-Knox amounted to only one-quarter of one percent of all steel purchases in the U.S. and as such were insignificant. He stated:

> ...there is a reasonable probability that the district court after final hearing may find that the proper comparison is between the steel purchasing power of Allis-Chalmers and that of the competitors of Blaw-Knox in the rolling mills field and that it would show that Allis-Chalmers is a substantial buyer of steel in comparison to them.[167]

As Judge Aldisert noted in his dissent, this "conclusion is proffered [sic] without factual support."[168] He argues that with respect to reciprocity, the record was "devoid of sufficient facts to support a preliminary injunction..." and that "from the barest of facts, the majority have conjured vivid overtones of reciprocity in the rolling mill industries."[169] He insists that "the vice of reciprocity can only be determined in the context of the market involved" and that the trial record on this point "suffers from factual anemia."[170] Judge Aldisert quotes Justice Stewart that the courts cannot rely on "slipshod" information confusingly presented and ambiguous in its implications."[171] It would appear that the majority opinion in Allis-Chalmers v. White Consolidated represents the high-water mark in just this sort of thing.

The majority, having reversed the District Court, granted Allis-Chalmers a preliminary injunction preventing White Consolidated from acquiring additional shares. White's request for certiorari was denied by the Supreme Court in January of 1970. White Consolidated made no further move to acquire Allis-Chalmers. However, later in 1970 White Colsolidated sought to merge with the White Motor Corporation. The Justice Department sought and

obtained a preliminary injunction alleging a violation of Section 7. This case will be discussed later in this chapter.

U.S. v. NORTHWEST INDUSTRIES AND B.F. GOODRICH (1969)

In April, 1969, by means of an exchange of shares offer, Northwest Industries, a railroad turned conglomerate, proposed to merge with B.F. Goodrich, the large tire maker that had also become highly diversified. The U.S. Justice Department sought a preliminary injunction (alleging violation of Section 7 of the Clayton Act) preventing the merger of the two firms. In July of 1969 District Court Judge Will denied the injunction, being "unable to find that the Government has demonstrated probable success with respect to any particular line of goods or services in any area of the country or with respect to the anti-competitive effect of the increased potential for reciprocity inherent in a combined Northwest-Goodrich...."[172] He argued that the issuance of a preliminary injunction would foreclose a "more careful and comprehensive consideration of the possible anticompetitive effects of the proposed acquisition."[173] As a result he denied the Justice Department a preliminary injunction, but he did enter a comprehensive hold-separate and status quo order permitting Northwest to obtain more shares in Goodrich while ensuring that Goodrich was maintained as a separate viable, going concern.

There is a real difficulty in assessing the implications of the case for the development of the case law on reciprocity. While denying the Justice Department a preliminary injunction, he "recognized that there is a very real possibility, if not a probability" in a trial on the merits that the Government would establish the requisite anticompetitive effect of reciprocity to constitute a violation of Section 7.[174] On both the horizontal and vertical merger aspects and the potential for reciprocal dealing, the judge describes the facts in far more detail (including numerous quantitative measures) than was done in the Ingersoll-Rand and Allis-Chalmers v. White Consolidated cases. In coming to the opposite result as the District Court and Appeals Court respectively in the two cases cited above, he appeared to require much more conclusive evidence than did the other judges. Finally, we note that over three-quarters of Judge Will's opinion in this case dealt with the horizontal and vertical merger elements of the case. Reciprocity was a significant but lesser issue in this case.

With respect to the reciprocity aspect of the merger, the Justice Department advanced two main arguments: "First, it [suggested] that Northwest could secure freight shipments from other rail carriers in exchange for routing Goodrich shipments

over such carriers' lines. Second, it [suggested] that because rail service is frequently limited to a single carrier, shippers in the areas serviced exclusively by Northwest's railroads might purchase Goodrich products in the hope of securing better rail service."[175] The second was described by the Justice Department as reciprocity effect.

This is the first case in which the term "reciprocity effect" was used, although, as we have seen in the Ingersoll-Rand and Consolidated Foods cases, the idea of a firm directing its purchases to a firm to which it wishes to sell, in recognition of that firm's market power, is not new. However, in this case reciprocity effect takes on a slightly different twist. In return for purchasing from the Goodrich side of the merged firm, the reciprocity-initiating firm hopes to get better service from the railway component of the conglomerate rather than seeking to stimulate the conglomerate to purchase from it or to continue to purchase from it.

In his review of the evidence on reciprocity potential Judge Will noted, among others, the following points. In 1968 Goodrich spent about $60 million on freight, about 60 percent of which was rail traffic. Only $750,000 worth of such traffic used Northwest's railroads. It was pointed out that Goodrich exercised its right to route the traffic in over 90 percent of all its shipments. The Government contended that in light of the merger $2.4 million of Goodrich freight expenditures could be diverted from trucks to Northwest's railroads and that of another $2.2 million now passing over other railroads at least part could be rerouted over Northwest lines. Note that much of this evidence really deals with foreclosure in the markets for shipping by railway and by truck as a result of the vertical element of the merger. Northwest challenged the Government's estimates of freight diversion, arguing that only 700 Goodrich cars could be diverted from other railroads to Northwest--out of a total of 1,500,000 cars annually. Northwest also argued that the practices alleged by the Government would violate Interstate Commerce Commission regulations. In his evaluation of the evidence Judge Will stated, "the diversion estimates presented were general and inconclusive,"[176] and that the anti-competitive effect was "not determinable on the basis of the present record."[177]

Specifically, the reciprocity element was that by selecting certain railroads to carry Goodrich freight, Northwest would receive a variety of benefits from those railroads: an equal amount of interline freight; empty freight cars in times of shortage; and support for rate changes benefiting Goodrich or other Northwest shippers. In addition, Goodrich would be able to get better rail service and increase its sales to railroads interested in its freight through reciprocity effect.

Going beyond the gross reciprocity potential of aggregate size and diversification, the Government presented evidence that both customers and suppliers of Goodrich and Northwest practised reciprocity. It indicated that Alcoa, Cities Service, du Pont, Humble Oil, Enjay Chemical, Monsanto, Pittsburgh Plate Glass, Texaco and Container Corporation all engaged in reciprocity (Alcoa had a written policy favoring ceteris paribus reciprocity) and appeared to sell to Goodrich-Northwest more than they bought from the two firms. The Government contended that Velsicol Chemical, a subsidiary of Northwest, to use the judge's words, "is now and has been engaged in a full scale and vigorous reciprocity program."[178]

It also put into evidence the fact that one of Northwest's railroads purchased paper grain doors on the basis of reciprocity--contrary to the alleged instructions of Heineman, at that time chairman of the line.[179] Evidence was also introduced contending that Lone Star Steel, a subsidiary of Northwest, entered into a contract to purchase coal from an oil company on the implied condition that the oil company purchase tubular products from Lone Star.

To counter this evidence, Heineman, president and chief executive officer of Northwest (and instigator of the merger) testified that Northwest had "a policy against reciprocal dealing, considers such a practice uneconomic, and has no machinery for effectuating the practice."[180] When he took over Northwest's railroads he said he prohibited the practice and that he operated the various units of Northwest as separate profit centers. The latter, he argued, would result in unrequited reciprocity effect, to use Steiner's phrase. However, it was apparent that no written policy against the practice was disseminated in Northwest. Judge Will pointed out that "any comprehensive policy against reciprocity is a fairly recent development and a reflection of the personal philosophy of Mr. Heineman."[181] As to his ultimate findings of fact, Judge Will stated:

> While it is clear that the potential for reciprocity would be substantially increased, the extent to which actual reciprocity would be practiced and, therefore, the probable actual anticompetitive effect thereof is, on the basis of the present record, difficult if not impossible to forecast.[182]

Unlike some of his colleagues on the bench, Judge Will insisted that a violation of Section 7 requires a specific demonstration of a substantial lessening of competition in any section of the country.[183] Despite the ruling in this case, Northwest did not consummate its merger with Goodrich, perhaps because the latter was a most reluctant partner.[184]

## THE INTERNATIONAL TELEPHONE AND TELEGRAPH CORPORATION CASES

ITT, headed by the archetypal conglomerateur, Harold Geneen, has inevitably been involved in antitrust actions alleging violation of Section 7 of the Clayton Act.[185] Three of these cases dealing with reciprocity will be discussed in this section.

On March 3, 1969, ITT entered into a merger agreement with Grinnell Corporation, a manufacturer of power piping systems, automatic sprinklers and pipe hangers, with sales of $341 million in 1968. One month later it did the same with The Hartford Fire Insurance Company, the sixth largest property and liability insurer in the U.S., with revenues of $969 million in 1968. On April 25, 1969 Canteen Corporation was merged into ITT. Four-fifths of Canteen's sales in 1968 ($236 million) consisted of the sales of vending and manual food service to industrial, commercial, educational and medical accounts.

The Justice Department first moved for a preliminary injunction with respect to the acquisition of Grinnell and Hartford. District Court Judge Timbers denied the request (October 21, 1969), but directed hold-separate orders in each case. The Grinnell case was then tried on its merits before Judge Timbers, who ruled against the Justice Department in an opinion filed December 31, 1970. The Justice Department, following the acquisition of Canteen and an agreement by ITT to maintain Canteen as a separate entity, filed suit alleging that the merger violated Section 7. In a trial on the merits of the case the Justice Department failed to prove its case, ruled District Court Judge Austin.

By agreement, the Government's appeal to the Supreme Court was dismissed and the Justice Department obtained a Consent Decree in each of the three cases on September 24, 1971, under which ITT was required to divest part of Grinnell, all of Canteen and either Hartford or Levitt (a large home building firm), Avis (car rentals) and the Hamilton Life Insurance Company. In addition, Grinnell had to ensure that the purchaser of its Fire Protection Division give an undertaking to the Justice Department not to engage in reciprocal relations in the sale of automatic sprinklers for 10 years. Canteen, Hartford and ITT were barred for 10 years from engaging in reciprocity and were ordered to take anti-reciprocity actions.[186] Professor Stanley Boyle, in a long article on the three ITT cases, states "these divestitures had almost no effect upon the economic operation and strength of ITT and, that insofar as they purport to bring about relief, they constitute economic window-dressing."[187] F. Marion Hughes argues that the Supreme Court "would probably have condemned the ITT mergers in a decision as questionable

from an economic analysis as was Consolidated Foods."[188] He claims that while ITT "did have to divest itself of many of the holdings which the government believed presented problems...the present situation called not for a settlement for one company but for an elaboration by the Supreme Court upon the law affecting all future conglomerate mergers."[189]

ITT-Grinnell(1969)[190]

The Preliminary Injunction (1969). Although both the ITT-Grinnell and ITT-Hartford decisions regarding the preliminary injunction were contained in the same judgment we shall treat them separately because the former was later tried on its merits and the latter was not. In Grinnell the Justice Department argued Section 7 of the Clayton Act was violated and made two specific claims. First, that the merger would give Grinnell various marketing and promotional competitive advantages over its competitors in the form of an opportunity to engage in system or package selling, through affiliation with Hartford, through access to ITT's financial resources, and through foreclosure of Grinnell's competitors from foreign sales.[191] Second, in the words of Judge Timbers, "the proposed merger raises the probability of reciprocal dealing by creating a market structure conducive to such dealing."[192] Our discussion will focus on this issue, which was dealt with in the decision at the same length as the first claim.

The Justice Department asserted that the merger would permit both reciprocity through the use of pressure and reciprocity effect. Voluntarily or involuntarily, ITT's suppliers would transfer their purchases of automatic sprinklers (sales of $67 million in 1968) and pipe hangers (sales of $13.3 million in 1968) to Grinnell to curry favor with, maintain or increase ITT's purchases from them. It was argued that ITT's suppliers were actual or potential purchasers of sprinklers--specifically, that ITT purchased $350 million of goods and services from industries that accounted for 28 percent of total new plant and equipment expenditures and 67 percent of such expenditures by all manufacturing industries in the U.S. ITT argued that those responsible for the purchasing of automatic sprinklers (the product upon which the issued was focused) were not suppliers of ITT, e.g., 30 percent were sold to educational institutions, hospitals and retail establishments, and 80 percent of the remainder were sold as part of new construction work "where sprinkler work is done on a bid basis by general or mechanical contractors who are not significant ITT suppliers as a group or individually."[193] Judge Timbers stated that little or no evidence was offered with respect to other factors relevant to determining if conditions were conducive to reciprocity, i.e., product characteristics, the importance of ITT to its suppliers, size and diversification of other customers of ITT's suppliers,

and the degree of competition in the market in which ITT's suppliers operated.[194] On the question of opportunity or market structure conducive to reciprocity Judge Timbers found the record "inconclusive" and would not permit himself to make a finding on this point.[195]

As to the probability that reciprocity will, in fact, be practiced, the judge said the "substantial, credible evidence introduced by the defendants...precludes any finding based on what amounts to an inference suggested by the government that reciprocal dealing will occur."[196] The evidence explored here indicated that reciprocity potential was not part of the decision to merge, that ITT had a written policy against reciprocity, that ITT was organized around profit centers--each division having its own decentralized sales and purchasing departments and, it was argued, reciprocity effect would go unrequited.[197] Judge Timbers specifically rejected the Government's contention that once it has shown that a merger will create an opportunity for reciprocal dealing, such a merger violates Section 7. Consolidated Foods, Allis-Chalmers v. White Consolidated, Ingersoll-Rand and General Dynamics were cited by the government in support of its contention. The judge saw these cases as "readily distinguishable from the instant case."[198] He pointed out that in Consolidated Foods there was considerable past acquisition evidence and that Mr. Justice Stewart had ruled the opportunity alone is not enough. In General Dynamics there was also post acquisition evidence,"as well as evidence that the opportunity to engage in reciprocal dealing was one of the primary motives for the acquisition of Liquid Carbonic by General Dynamics."[199] While acknowledging that reciprocity potential was the main issue in Ingersoll-Rand and Allis-Chalmers, Judge Timbers argued there was a "crucial factual distinction" between these two cases and Grinnell in that "there was no evidence of company policy against reciprocal dealing...." in those two cases, unlike that in Grinnell.[200] In Penick & Ford, he pointed out that while Reynolds submitted evidence that there was a company policy against reciprocity the government did not rebut it. With respect to the Northwest Industries case, the judge indicated that Northwest introduced evidence that it had a policy against reciprocal dealing, yet he did not indicate Judge Will's evaluation of Northwest's "policy" that we noted above. Judge Timbers asserted that, unlike the Penick & Ford and Northwest Industries cases, "the government has not established the existence of an organized reciprocity program or a prior history of reciprocal dealing by defendants or their suppliers."[201] We move now to Judge Timbers' decision following the trial on the merits of the case.

Trial on the Merits (1970). At the trial on the merits the Justice Department's claims of violation of Section 7 were of two major types. First that Grinnell is the dominant com-

petitor in certain lines of commerce and in certain sections of the country. This claim was based on what Judge Timbers describes as "well settled" law "that when a company which is the dominant competitor in a relatively oligopolistic market is acquited by a much larger company, such acquisition violates Section 7 of the Clayton Act if the acquired company gains marketing and promotional competitive advantages from the merger which will further entrench its position of dominance by raising barriers to entry to the relevant markets and by discouraging smaller competitors from aggressively competing."[202]

The judge ruled that Grinnell was not the dominant competitor in any relevant market and indicated he was tempted to enter judgment for ITT at that point.[203] He then proceeded to the government's second set of claims assuming, arguendo, that Grinnell was a dominant competitor in the automatic sprinkler devices and installation markets. The second claim was that the merger would confer marketing and promotional advantages upon Grinnell not available to its competitors. Four of the seven were listed in the discussion above (p. 137). To these the government added vertical foreclosure, ITT assistance in reentering the central station alarm business, and reciprocal dealing.[204] Judge Timbers indicated that "the major marketing and promotional competitive advantage which the government claims Grinnell will gain from the ITT-Grinnell merger is an enhancement of Grinnell's market position through reciprocal dealing caused by ITT's large purchasing power."[205]

The judge followed very closely the analysis he made in the hearing on the preliminary injunction. He stated there were two factual requisites. First, whether the merger creates an opportunity for reciprocity and second, whether such reciprocal dealing in fact is likely to occur. He listed the variables associated with the question of whether the merger will create a market structure conducive to reciprocity as he had in the preliminary (see pp. 137-138) but he devoted almost all of his discussion to the issue of the extent to which ITT's suppliers were actual or potential customers of Grinnell's automatic sprinkler installations. Judge Timbers reviewed the government's point that ITT made purchases of $100,000 or more from industries which accounted for 71 percent of total new plant and equipment expenditures by manufacturing industries in 1966.[206] But he followed ITT's submission that "the number of companies from which ITT in fact purchases is a more reliable measure of maximum reciprocity and reciprocity effect potential...."[207] Further, the government's witnesses with experience in the sprinkler industry testified, with few exceptions, that there were no instances of actual or suspected reciprocity. The judge again pointed out that "a substantial and increasing proportion of sprinkler work is done for nonindustrial customers" and that most sprinkler work "is awarded on a competitive bidding

basis, thus minimizing reciprocity and reciprocity effect potential."[208] Finally, he argued, a large proportion of sprinkler work is done as part of new construction "where sprinkler installers bid largely to general and mechanical contractors rather than to owners, thus minimizing the likelihood of significant ITT purchases from industrial sources."[209]

On this last point Judge Timbers' analysis can be challenged in that he has ignored the possibility of secondary or three-way reciprocity. As Hughes puts it:

> ITT may not have any direct influence over the general contractors who buy most of the sprinkler systems, but ITT does have power to influence the purchasers of the new construction who are the suppliers of ITT.[210]

In other words, ITT pressures its large suppliers, who are also in the process of building new plant and equipment to tell their general contractors to specify Grinnell sprinkler equipment in sending the job out for bids.[211] As was noted in the General Dynamics case, even the government bidding regulations for defence contractors have enough room in them for management to exercise its influence over who bids and to what specifications. Judge Timbers' faith in the ethical standards of general contractors[212] is touching, but a little naive. There is nothing to prevent the purchasers of new construction from instructing the general contractor to request bids from sprinkling system installers on the basis of Grinnell equipment. The FTC Staff Report on corporate mergers reported several instances of exactly this sort of thing.[213]

As further evidence that the market structure was not conducive to reciprocity the judge reviewed the period before the merger when Grinnell had no established policy against reciprocity and concluded that "the record shows that reciprocity was not a significant factor in Grinnell's sprinkler business...."[214] He did, however, feel it was necessary to point out that where reciprocity allegedly existed it had occurred five years earlier and a number of the companies involved had signed consent decrees enjoining the practice.[215]

On the issue of whether reciprocity was in fact likely to occur Judge Timbers concluded it would not for three reasons: (1) the fact that ITT was organized into profit centers and reciprocity would not enable each center to maximize its profit independently, (2) the fact that ITT did not collect purchasing and sales data necessary to identify reciprocity opportunities, and (3) the fact that ITT had had a written policy against reciprocity since 1966 and the government did not provide evidence that any ITT unit obtained business as a result of reciprocity or reciprocity effect.[216] As we shall see in our discussion of ITT-Hartford, each of these barriers to actual reciprocity can be challenged.

ITT-Hartford (1969)

Although the government made five specific claims[217] in its request for a preliminary injunction, the one with respect to reciprocal dealing was the "primary" one.[218] Judge Timbers stated:

> The government asserts that as a result of the proposed merger ITT will be able to exert pressure on its suppliers to switch their insurance business to Hartford by conditioning ITT's purchases...on the suppliers' agreement to purchase insurance from Hartford.[219]

The government introduced evidence indicating that ITT suppliers accounted for from 6.5 percent of the property and liability insurance market to 19 percent of the market for group health, life and accident insurance sold to employers. But the judge never really got beyond the issue of whether insurance is the type of product that lends itself to reciprocity. Two main points were raised in regard to whether insurance is sufficiently homogeneous to permit reciprocity: (1) the existence of insurance managers and brokers "as indicative that insurance purchasing decisions are complicated decisions which do not lend themselves to reciprocity considerations," (2) the assertion that insurance relationships are long term and "that there is little if any motive for an insured to switch from one insurer to another." To buttress this point reference was made to insurers' reluctance to bear heavy start-up costs if a firm is a "switcher," and to the build-up of a surplus where actual claims are below estimates.[220] Judge Timbers, presented with conflicts in evidence and expert testimony, ruled that insurance did not lend itself to reciprocal dealing.[221]

On almost every point raised by ITT, and on balance accepted by the judge, Denenberg and Cummins disagree. They argue that "companies can and often do change insurance companies for good reason, and reciprocity is one good reason." Their survey of risk managers of large corporations indicated that "one change does not a 'switcher' make," and in some cases a "surplus" built up over time is returnable upon cancellation.[222] Their central argument is that "insurance is not only susceptible to reciprocity; in many ways it is ideal for the practice of reciprocity."[223] They give the following reasons: (1) insurance is a universal necessity for every kind and size of business; (2) Hartford as a firm is a leading insurer and universally acceptable in terms of solvency, contracts (all lines ability to provide any kind of competitive contracts, service considerations, i.e., claims adjustments, engineering services nationwide) and price ("for many kinds of insurance there is virtually no price competition"); (3) the methods of purchasing, i.e., a centralized insurance department aware of

the firm's major customers, tendency to switch insurers more frequently than brokers, and the fact that "insurance changes generally involve no disruption of the production line..." and businessmen seldom have strong preferences for specific insurance companies.[224]

Judge Timbers was the first to hold that one of the elements essential to create an opportunity for reciprocal dealing" is "whether [a firm's] suppliers operate within an oligopolistic or concentrated market with dull price competition."[225] Denenberg and Cummins challenge this proposition. They point out that the judge's argument is true only in the sense that ITT-Hartford tried to sell insurance to an ITT supplier on terms less favorable than those available to the supplier's competitors. "However, the court does not recognize that in a multiproduct situation... ITT has an incentive to sell [insurance to its suppliers] on terms equivalent to those which [they] could obtain from other firms."[226] That ITT's suppliers would be willing to engage in true ceteris paribus reciprocity simply because ITT is one of its customers is the essence of Denenberg and Cummins' rebuttal to Judge Timbers. They point out that while the market for the competitively produced input purchased by ITT is not affected, such reciprocity would allow ITT-Hartford to expand its market share at the expense of other insurers who are not buyers of the input purchased by ITT.[227] We have already pointed out the fatal weaknesses in this argument in Chapter 5.[228]

The factors seen by the court as militating against the actual practice of reciprocity by ITT were also questioned by Denenberg and Cummins, including the reliance on ITT President Geneen's testimony, "an obviously biased witness."[229] They state "a general antireciprocity policy is not inconsistent with the use of reciprocity on an ad hoc basis. In fact, reciprocity is most important in marginal cases, i.e., those in which the product price, quality and service attributes... are quite evenly matched."[230] Even without the availability of purchasing data, sales personnel are probably aware of the identity of their firm's big suppliers or are able to obtain such information, they argue.[231] More importantly, Denenberg and Cummins point out that large enterprises of the multi-division or profit-center form have a "'general office' which coordinates the activities of the individual profit centers and sets strategic goals of the conglomerate as a whole."[232] They give some evidence that ITT operates a strong general office.[233] In light of the evidence, in this and the other ITT cases, that ITT does not appear to practice any form of reciprocity, Denenberg and Cummins' points are of more theoretical than practical relevance.

ITT-Canteen (1971)

The Justice Department's case against ITT's acquisition of the Canteen Corporation (which went directly to a trial on the merits) was based on three probable effects of the merger: reciprocity and reciprocity effect, vertical foreclosure and barriers to entry, and the triggering of other mergers. Judge Austin's discussion of the last two accounted for less than two pages as compared with more than 13 pages of his opinion devoted to reciprocity and reciprocity effect.

At the outset he stated "there are three prerequisites to a finding that a merger violates Section 7:

> First, the merger must significantly increase the opportunities for reciprocal dealing;
>
> Second, there must be a reasonable probability that those opportunities will be exploited; and
>
> Third, the resulting reciprocal dealing, if any, must have a tendency to substantially lessen competition.[234]

Following Judge Timbers in ITT-Grinnell and ITT-Hartford, he listed five factors to be considered to see if there had been a significant increase in the opportunities for reciprocal dealing.[235] Judge Austin noted that the Government's economist had not considered several of these factors in his evidence and that the defendant had provided evidence strongly refuting his position on the issues to which he had addressed himself.[236] He then reviewed the evidence on each of five factors:

1. The extent to which ITT's suppliers are actual or potential users of Canteen's food service. The Government indicated that ITT makes purchases of $100,000 or more in industries which account for 55.7 percent of the total number of industrial employees and 53.1 percent of the total number of plants with more than 250 employees. But, the judge pointed out, ITT purchases from only 0.58 percent of the companies operating in industries which it is a buyer. At the level of individual supplier, ITT and Canteen made purchases of $20,000 or more from 3,800 companies in 1968. But no evidence was supplied to show whether the plants of the sample of 375 firms in this group were in areas in which Canteen operated or were suitable for Canteen's industrial food or vending service.[237]

2. The scope of the market represented by ITT for the products sold by its suppliers, i.e., for other than innocuous forms of reciprocity, ITT's purchases would have to constitute a significant fraction of its suppliers' sales. Judge Austin stated that "ITT's purchases represented an inconsequential percentage of its suppliers' sales. For example, ITT's and Canteen's purchases of $20,000 or more from companies on the Fortune 500 list averaged only 0.118 percent of those suppliers total sales."[238]

A more comprehensive analysis would recognize that many of firms in the top 500 industrials are broadly diversified enterprises. The point is to determine the absolute number of firms or divisions of diversified firms at the four- or five-digit level for whom ITT is an important buyer. In other words we need to look at the right-hand tail of the distribution of ITT's purchases at a lower level of aggregation.

3. The extent to which an ITT supplier also sells to Canteen's competitors in the food and vending service industries, i.e., by engaging in reciprocity with ITT-Canteen, the supplier would be sacrificing its opportunity to sell to Canteen's competitors. Specifically, the judge noted that the purchases both individually and in the aggregate of Canteen's competitors are very significant and can act as a "counterbalance" to ITT-Canteen's buying power.[239]

4. The degree to which the markets in which ITT buys are competitively structured and provide "no real opportunity for reciprocal dealing."[240] The Government offered no evidence on this point. Our comments, following the analysis of Ferguson[241] and Denenberg and Cummins, were discussed in the preceding case and in Chapter 5.

5. The extent to which food service (which the judge held to include vending and manual on-site food service) is a product that lends itself to reciprocal dealing.[242] In Chapter 5 we noted that it is generally argued that homogeneous or closely substitutable products or services for which prices are essentially the same most easily lend themselves to reciprocal dealing. Judge Austin, on the basis of his earlier review of the matter[243] said "the food service business is characterized by frequent and important variations among suppliers in the types of food service systems utilized in the quality of food products and service provided and in the prices and contractual terms offered."[244] He concluded that the product was not "highly susceptible" to reciprocal dealing.[245]

With respect to his second prerequisite, that there is a reasonable probability that the opportunities for reciprocity will be exploited, Judge Austin noted that in Consolidated Foods the Supreme Court had ruled "the 'mere possibility' of the prohibited restraint is not enough." He also quoted Justice Stewart that "It requires more than this kind of bare potential for reciprocal buying to bring a merger within the ban of [Section] 7." He pointed out that in the Grinnell and Hartford cases Judge Timbers specifically rejected the Government's contention that "as a matter of law...once it has shown a merger will create an opportunity for reciprocity dealing, that is sufficient to halt the merger under Section 7."[246] In support Judge Austin also reviewed the Northwest Industries, Penick & Ford and General Dynamics cases.[247] He noted that in U.S. v. White Consolidated Industries (to be discussed next) the Court, following the Ingersoll-Rand and Allis-Chalmers decisions, ruled

that an acquisition which creates a market structure conducive to reciprocal dealing presents the acquiring company with an advantage over competitors which by its very nature is anti-competitive."[248] He then went on to point out that the judge in White Consolidated had acknowledged that those cases "had failed to gain acceptance" outside the Third Circuit and that no effort was made to discuss or distinguish any of the contrary authorities."[249] Judge Austin stated that the Grinnell decision reflected "a better view of the law, it avoids the extreme and untoward results of a rule based on a bare potential for reciprocal dealing."[250] It is hard to disagree with this conclusion.

From his review of the record, Judge Austin concluded that it "negated any probability those opportunities [which he had earlier found nonexistent] would lead to significant reciprocal dealing by ITT Canteen."[251] In his discussion he noted the following:
(a) despite an exhaustive search over a period of five years prior to the case, the Government produced no evidence that ITT practiced reciprocity;[252]
(b) testimony by ITT President Geneen indicated that there is no likelihood ITT will change its antireciprocity policy. Geneen described reciprocity as, "a very costly, noncompetitive, expensive practice."[253]

Further, the judge cited with approval ITT's economist's (Prof. Peter Steiner) point that ITT would be better off to use its purchasing power directly to lower its input costs rather than indirectly to influence its Canteen's sales via reciprocity.[254]
(c) it was again noted that ITT "does not collect the type of purchase/sales data which is essential to a systematic reciprocity program."[255]
(d) as in Grinnell, ITT pointed out and the judge accepted the argument that ITT is organized around profit centers and that "there is a strong incentive for the profit center management to avoid any reciprocal trading."[256] Hughes asserts, "the argument is imperfect, however, since several managers may collaborate to work out a solution favorable to all. Further it is entirely inapplicable where reciprocity is used merely to capture all the business when the prices are the same as those of competitors."[257] Denenberg and Cummins expand on Hughes' first point. "A type of 'double reciprocity' could occur by which the directors of two or more profit centers could agree to aid each other in practicing reciprocity against outside firms. This type of favor swapping by division managers is probably not uncommon and would certainly be easy to implement."[258] They go on to argue that in multi-division firms top management often recognize the contributions by one division to another in evaluating each profit center's performance.[259] Even Williamson, who argues that multi-divisional organizations are generally poorly suited to engage in reciprocity,[260] recognizes the existence of favor swapping among the operating divisions of such enterprises in the matter of internal procurement.[261]

Judge Austin pointed out that the various intra-firm organizational and policy elements cannot ensure that no instance of reciprocity will ever occur in ITT, but "they provide meaningful safeguards against any significant practice of reciprocity."[262] He noted that the Government had insisted that several of these safeguards be included in its recent consent decrees.

Reciprocity effect was dismissed as a temporary phenomenon since such unilateral channelling of business to Canteen by ITT's suppliers would be unrequited and the suppliers would have no reason continue when ITT did not reciprocate. The judge pointed out that in the 20 months between the merger and the trial there was no evidence that ITT or Canteen had benefited from reciprocity effect. But he goes too far when he states that, "the pendency of the litigation can have no influence on the actions of ITT's suppliers."[263]

Finally Judge Austin noted that the Government had led no evidence that Canteen's competitors engaged in reciprocity or benefited from reciprocity effect during the past three years.[264]

We come now to the third requirement, that the resulting reciprocal dealing must have a tendency to substantially lessen competition. Since he had previously determined there was neither opportunity or a reasonable probability of utilizing the opportunity for reciprocal dealing, the judge had to indicate there was no likelihood that the merger would substantially lessen competition by reason of reciprocity.[265] However, Judge Austin did feel it necessary to devote five pages of his opinion reviewing the contention that Canteen, prior to the merger, was engaged in a reciprocity-related trade relations program He concluded that between 1961 and early 1968 Canteen had "maintained an active trade relations program...although the nature and scope of the program was gradually diminished during those years."[266] In only 10 instances did the Government contend that Canteen had obtain business through reciprocity and in only 15 involving reciprocity effect.[267] The judge ruled that even if in all these instances the Government's contention was correct, the amount of business secured was de minimus,..."such activities were both sporadic and insignificant in the acquisition of food service business."[268] This was corroborated by competitors who lost business to Canteen allegedly because of reciprocity.[269] Two points were cited by the judge in support of his conclusion that, given the absence of any past impact from reciprocity or reciprocity effect, "there is no reason to anticipate that the ITT-Canteen merger will lead to such a result."[270] First "There is ITT's proven antireciprocity policy," and second there is "the changed business and legal attitude toward reciprocity and trade relations activities."[271] In the latter point Judge Austin referred to 10 consent decrees and seven assurances of voluntary compliance. He also stated that of

37 companies replying in sworn statements, 31 had a definite policy against reciprocal buying, and 22 of these said their policies were in writing.[272] We would counter this evidence of changed business attitude with results of Markham's and Bird and Shepherd's studies which we reviewed in Chapter 4.

Like Judge Timbers in ITT-Grinnell and ITT-Hartford, Judge Austin ruled that the merger of ITT and Canteen Corporation did not violate Section 7 of the Clayton Act. ITT's "victory" in this case was purely Pyrrhic as it was forced to divest itself of Canteen as part of a consent decree.

### U.S. V. WHITE CONSOLIDATED INDUSTRIES, INC. AND WHITE MOTOR CORP. (1971)

Although this case was decided four months before ITT-Canteen, we have chosen to keep all three of the ITT cases together in our discussion. White Consolidated, thwarted in its attempt to acquire Allis-Chalmers, sought to acquire the White Motor Corporation in 1970. The Justice Department, alleging that the merger would violate Section 7 of the Clayton Act, sought a preliminary injunction to halt the merger pending a trial on the merits. In a decision of less than three pages filed on February 24, 1971, District Court Judge Battisti granted the preliminary injunction.[273]

The Government raised three issues with respect to the merger: (1) vertical effects of sales by White Consolidated to White Motor, (2) horizontal effects resulting from WC's acquisition of Allis-Chalmers, and (3) reciprocity effect. The judge dealt with the first only briefly, stating "such a policy (of keeping purchases within the family) is not, of course, anticompetitive in itself, but it does serve to indicate the inevitable impact the merger will have."[274] He dismissed the second as moot since "the recent court-ordered divestiture of Allis-Chalmers."[275] Therefore, the central issue brought by the government was not over reciprocity but reciprocity effect--"an alleged tendency for prospective suppliers of a firm to direct their purchases to that firm in order to maintain its goodwill."[276]

Judge Battisti pointed out that the issue was first noted in Ingersoll-Rand and followed by the Third Circuit Count of Appeals in that case, "but in general the theory has failed to gain acceptance outside that circuit."[277]

He then argued that the decision in Allis-Chalmers v. White Consolidated was based "largely on the probability of an anticompetitive 'reciprocal effect.'"[278]

Although he stated he was not bound by the decisions of the Third Circuit Court of Appeals, Judge Battisti said "the logic of its opinion in the Allis-Chalmers case seems both inescapable and quite compelling."[279] In particular, he asserted that the combined purchases of steel of White Consolidated and White Motor would aid Blaw-Knox in selling its rolling mill equipment to the steel industry. He did, however, acknowledge that White Motor was a smaller purchaser of steel than Allis-Chalmers so "the effect here will not be so drastic... but the same forces can be seen operating here as in that case."[280]

At no place in his opinion did Judge Battisti refer to the Supreme Court's ruling in Consolidated Foods that the mere possibility of reciprocity is not enough to violate Section 7 or to Judge Timbers' careful analysis of the various cases in ITT-Grinnell and ITT-Hartford. The basis for Judge Battisti's decision appears to be found in his fears of conglomerate mergers in general. He stated that this case was "a skimmish in a broader battle over the direction American economic life will take in the coming years."[281] "The undesirable effects of such a merger are totally unrelated to the motives of the parties; rather their mere size in the market will operate as a lever which in turn will lessen competition."[282]

While White Consolidated raised the point that it operated on a profit-center system, Judge Battisti, unlike Judges Timbers or Austin in the ITT cases, would have none of it. He said the evidence indicated a "much firmer and more centralized control that the defendants would have us believe...."[283]

## THE SHERMAN ACT CASES[284]

If our tour through the Section 7, Clayton Act cases has not resulted in a clear statement as to the judiciary's posture on reciprocity arising out of mergers, then it is discouraging to note that the Sherman Act cases provide even less of a "pattern."

### General Dynamics (1966)[285]

This was the first case in which the Justice Department attempted to have reciprocal dealing arrangements declared a violation of Section 1 of the Sherman Act. To deal with the alleged violation of Section 1, Judge Canella reviewed the reciprocal dealings between Liquid Carbonic and six of General Dynamics' suppliers to see if "specific contracts or combinations" had occurred as a result of the Special Sales Program. Only two satisfied his multiple, but implicit, criteria. They totaled $177,225.[286] One was rejected as a "mutual patronage

arrangement, each agreeing to buy from the other in return for increased sales."[287] He ruled that leverage was absent, but that such an arrangement reflected the use of purchasing power to generate sales! In addition, in this "contract" and others no dollar amounts were given, e.g., one was a full requirements contract. "This being the case, the government has failed to prove that the relationship at issue was violative of Section 1 of the Sherman Act."[288]

The strictness of the judge's test for a Section 1 violation is seen from the evidence presented in connection with Liquid Carbonic's sales to Raytheon. These showed obvious attempts at reciprocity and at least a certain amount of carbon dioxide was marked as sold to the account. But the evidence was rejected. Judge Cannella gave the following reason:

> ...its mere entry on the corporate books as business secured by the Special Sales Program is not sufficient proof to establish that the sale in question was actually obtained by reciprocity.[289]

He went on to say that:

> Since no all-embracing agreement between two companies has been shown, or may legitimately be inferred, the government must show that reciprocity contacts caused the...sale.[290]

Recognizing there might be great difficulty in connecting the attempts at reciprocity with specific contracts of sale, the Justice Department tried to avoid the problem by submitting that the Court could infer the existence of contracts in restraint of trade from statistics and statements by the defendant's executives that the reciprocity program was effective. While it is true that very useful inferences can be drawn once a plan to engage in restraint of trade is proven, they are usually inferences of general intent in connection with specific acts. Therefore, while intent was established and the total volume of trade was not unsubstantial, the Government was unable to show specific contracts for reciprocal dealing resulting from the Special Sales Program. It is doubtful whether inferences of the commission of the specific acts (i.e., the contract of sale) could justifiably be drawn as well. But Judge Cannella had a different reason for rejecting the submission:

> The Section's [Sherman Act, Section 1] reference to contracts...is necessarily directed at bilateral arrangements...the business secured could be the result of the mere presence of the reciprocity power .... Vendors of General Dynamics, to curry favor or protect present sales to the defendant, might unilaterally decide to purchase the products of Liquid Carbonic. In such instances, no actual contacts would serve as a predicate for a Sherman Section 1 violation.[291]

Thus it would seem that under Section 1 it is impossible to reach specific instances of reciprocity effect. However, judge Cannella may have overstated his proposition. First, "protect present sales" implies that the sales are being threatened. Thus negative psychological reciprocity is more likely to be involved than simple reciprocity effect. Also, in the case of the Raytheon sales, at least, it was clear that Liquid Carbonic initiated the reciprocity overtures. While he proposed a test under Section 1 for reciprocity agreements to violate the law, Judge Canella ruled that this case was "an inappropriate vehicle for finding an amount considerably less than $500,000 as 'not insubstantial,'" as the government had proven that the merger itself had violated Section 1.[292] Earlier in his judgment he had stated:

> The court has found that there was a bilateral intent, at the time of the merger, to foreclose competition by the use of reciprocity...the defendant's statistics and the statements of its officers...indicate that a significant amount of commerce was foreclosed....The defendant's penchant for not keeping records of reciprocity matters prevents a precise 'dollar amount' finding. However, it is clear that the amount involved is 'not insubstantial.'[293]

Thus it would seem that where there is a merger between two companies, one need only show bilateral reciprocity intent and that a (possibly imprecise) not insubstantial amount of commerce was foreclosed to prove the merger violates the law. Later, the judge further developed his test which he based on three factors. The first was his acceptance of the analogy between tying agreements and reciprocity which was extended to include both mutual patronage and coercive reciprocity, viz., "Reciprocity, whether mutual or coercive, serves to exclude competitors by the exercise of large-scale purchasing power. This court concludes that the analogy of reciprocity to 'tying-in' arrangements applies to both forms of reciprocity."[294] Second, Judge Canella followed the Supreme Court's ruling in the Times-Picayune (1953) case that tying-in arrangements are per se violations of Section 1, if a "not insubstantial" amount of commerce is affected. Third, he followed the Supreme Court in the International Salt (1947) case where it ruled that the test of substantiality depends on absolute, not relative, foreclosure and $500,000 was held to be a "not insubstantial" amount.[295]

In summary, Judge Canella specified a test to determine whether certain forms of reciprocal dealing violate the Sherman Act Section 1, but he did not make a ruling of the basis of his test as he had already held the merger itself violated Section 1.

Columbia Nitrogen v.
Royster Company (1971)[296]

In 1971, Columbia appealed a judgment of $750,000 in favor of Royster for breach of contract concerning the sale of phosphate by Royster to Columbia. One of the grounds on which Columbia defended and counterclaimed was based on Royster's alleged reciprocal trade practices. The district court submitted only the issue of coercive reciprocity to the jury and the jury found for Royster on both the contract claim and the antitrust counterclaim. The Court of Appeals of the Fourth Circuit ruled that Columbia was entitled to a new trial on the contractual issues and affirmed the District Court on the antitrust issues.[297]

Columbia argued that Royster had violated Section 1 of the Sherman Act by engaging in reciprocal dealing, specifically "that Royster had exerted economic leverage through its purchases of nitrogen from Columbia to coerce Columbia to sign a phosphate contract."[298] The Appeal Court noted that Columbia, by a long-term written contract, had agreed to purchase about $4,750,000 worth of phosphate conditioned on anticipated purchases of approximately $4,000,000 worth of nitrates by Royster from Columbia."[299] The Court concluded that the "agreement was reached voluntarily by both parties who enjoyed sufficient economic strength to appreciably restrain free competition in the market."[300]

In the appeal, Columbia argued that noncoercive reciprocity (which the District Court declined to submit to the jury) violated Section 1. The Appeals Court quoted Judge Canella in General Dynamics that "reciprocity whether mutual or coercive, serves to exclude competitors by the exercise of large scale purchasing power." The Appeal Court then stated:

> In view of our disposition of this aspect of the case we may assume without deciding, that the reciprocal dealing disclosed by this record violated [Section] 1 of the Sherman Act.[301]

The Court held that a party who enters into a voluntary, noncoercive reciprocal dealing arrangement cannot maintain an action under Section 1 against its trading partner.[302]

Stavrides et al. v.
Mellon National Bank
and Trust Co. et al. (1973)

This case was a class action in which Stavrides claimed that Sections 1 and 2 of the Sherman Act were violated by the Mellon Bank's requirement that its mortgagors in order to obtain mortgages had to deposit, monthly, one-twelfth of the

annual taxes and fire insurance premiums on the mortgaged property.[303] Specifically, Stavrides claimed (a) that the extension of mortgage credit was conditioned on the borrowing, making the monthly deposits to the non-interest-bearing escrow accounts and as such was an illegal tying arrangement, and (b) that the Bank would not extend credit unless the bo-rower would offer to make the escrow deposits and that maintaining the deposits was a condition of obtaining credit; hence an illegal reciprocal dealing arrangement.[304]

The defendants' motion for dismissal for failure to state a claim upon which relief can be granted was denied with respect to (a) but granted with respect to (b). The judge ruled that:

> ...the concept of reciprocity [which he defined as a policy of favoring one's customers in purchasing commodities sold by them] could be stretched too far if we were to hold that the plaintif's willingness to open interest-free accounts was a "product which they 'sold'" in the course of a mutually beneficial relationship with the banks.[305]

The point that the same practice cannot be both a tying arrangement (conditioning the sale of one good on the sale of another) and reciprocal dealing was not raised. The maintenance of monthly tax and insurance deposits is analogous to the requirements by banks that borrowers maintain compensating balances. Austin and Solomon observe that "the tie-in assumption holds that the bank 'ties' demand deposits to the sale of credit. The reciprocal trading classification assumes that the bank, in exchange for the extension of credit, requires the borrower to reciprocate with an input of demand deposits....The compensating balance convention fits neither classification snugly."[306]

With respect to *Stavrides*, if one perceives the mortgagor to be a *customer* for the funds he receives and a *customer* for the compensating balance he must maintain, or deposits he must make with the bank, then the scheme is a tying arrangement. On the other hand, if one perceives the mortgagor to be a customer for the funds he receives but a *supplier* of the compensating balance to the bank, then the scheme is reciprocal dealing. We would argue that if one looks at the scheme in terms of the borrowing and lending of capital, it is really reciprocal dealing rather than a tying arrangement. This may be a significant distinction as it is not clear that the law relating to tying and reciprocity will always produce the same results.

*Carlson Companies v.*
*The Sperry and Hutchinson Co. (1974)*

Carlson contended that S & H (purveyors of trading stamps) and some of its suppliers had agreements whereby S & H agreed to

purchase goods for its redemption catalogue on the condition that the suppliers used S&H incentive programs in violation of Sections 1 and 2 of the Sherman Act.[307] In response to S & H's motion for summary judgment District Court Judge Larson stated that:

> Inferences of reciprocity can be drawn from the bare fact that S&H patronizes its own customers and that it sells incentive programs to the same entities from which it buys merchandise, even though such inferences may, at this point be highly speculative.[308]

Thus he ruled that the facts presented to him represented a material issue of fact. For this reason, and the one that the discovery procedures were incomplete, the judge refused the motion for summary judgment. Since we were able to discover no subsequent proceedings, the ruling is of very little judicial value.

W.L. Gore & Associates Inc. v.Carlisle Corp (1974)[309]

In this case Carlisle alleged that Gore had threatened to discontinue its substantial purchases of conductor wire from Carlisle in order to persuade Carlisle to recognize the applicability of Gore's patent to another wire product, (PTFE flat laminated cable) made by Carlisle and accept a licence.[310] The court was asked to consider whether Gore's threatened refusal to buy (which was not carried out) constituted an unlawful demand for reciprocity. As the judge summarized the issue, Gore "clearly attempted to use its buying power in the conductor [wire] market to obtain several advantages in its sale of PTFE cable: (1) terminating defendant's challenge to the validity of the patents in suit; (2) ending defendant's infringing sales of PTFE cable; and (3) securing a royalty on defendant's sales."[311]

The judge asserted that in the Columbia Nitrogen and General Dynamics cases it had been decided that a contract, combination or conspiracy to engage in reciprocal dealing can restrain trade in violation of Section 1 of the Sherman Act.[312] Although he accepted Carlisle's view of the facts, Judge Wright nevertheless found they did not disclose a violation of Section 1 because, as he said:

> [They] show only a unilateral threat by Gore not to buy...The defendant did not acquiesce in the plaintiff's demands, nor did the plaintiff enlist the assistance of others in a campaign to force defendant to accept a license. Thus there was here no colorable contract...and the 'collaborative element'...has not been proven.[313]

With respect to a violation of Section 2 he stated, "although this court has found no cases so holding, use of reciprocity to monopolize or to attempt to monopolize interstate commerce can, upon a proper factual showing violate Sherman Act [Section] 2."[314] To make a case for such a violation, the judge stated, the "defendant must show that plaintiff specifically intended to monopolize the relevant market through the use of unfair methods of competition...and that there was 'a dangerous probability' of success."[315]

The court found Gore had specific intent to monopolize the PTFE cable market because their license proposal disclosed the intent to exercise the exlusionary power of their patent to the fullest extent. The threatened refusal to purchase conductor cable from Carlisle was held to be an unfair method of competition even though market domination through patent enforcement might be exempt from antitrust law. The attempt would probably have been successful, it was said, because the preponderance of Gore's purchases of conductor wire over Carlisle's total PTFE cable sales would give Gore such leverage as would be likely to affect the judgment of Carlisle as a reasonable businessman.[316] This is the only case by the end of 1975 in which any type of reciprocal dealing was held to be a violation of Section 2.

U.S. V. Airco, Inc. (1974)

In this case the Justice Department charged that Airco (formerly the Air Reduction Company Inc.) with sales in 1972 of $518 million, had since 1959 violated Section 1 of the Sherman Act "by entering into combinations involving reciprocal arrangements" with its suppliers. They also charged that Airco violated Section 2 "through the use of its purchasing power... by attempting to monopolize..." the sale to its actual and potential suppliers of ferroalloys, industrial gases and other products made by Airco.[317] After completion of the government's case Airco moved for dismissal on the ground that upon the facts and the law the government had shown no right to relief. U.S. District Court Judge Bonsal granted the motion, dismissing the case.

With respect to Section 2 the case was dismissed in one paragraph because "the government has not introduced any evidence defining the relevant market."[318] Virtually the entire judgment was devoted to a discussion of the evidence relating to the Section 1 charge, regarding which Judge Bonsal stated General Dynamics was the leading case. Specifically, he quoted Judge Canella's emphasis on bilateral arrangements.

> To prove the presence of vendor contracts on condition, particular contracts with identifiable parties must be introduced into evidence or legitimately inferred from the conduct of such identifiable parties.[319]

As we have seen in our earlier discussion of the General Dynamics case, in implementing his test Judge Canella was loath to infer bilateral arrangements from apparently reciprocity-related behavior.

Even if a specific reciprocity contract was established by the evidence, a violation may still not be proven, because the contract did not disclose the volume involved. Moreover, even if the volume of trade foreclosed by reciprocal dealing is disclosed by the evidence, Judge Cannella held, it must be expressed as a dollar amount and a likely minimum unit value cannot be judically noticed. Finally, where all these requirements are met, Judge Canella ruled, the suit may still fail unless the total amount of commerce foreclosed is "not insubstantial." In the Airco case Judge Bonsal held to the rigorous standards enunciated in the General Dynamics case. The evidence showed that Airco operated an active trade relations program between 1958 and early 1972. The Airco executive responsible for this function, the Manager of Commercial Relations, was a member of the Trade Relations Association from its inception in 1962, became a director in 1968 and was president of the Association from 1970 until it became inactive in late 1971 or early 1972.[320] Between 1965 and 1971 Airco made computer lists of purchases from and sales to Airco's major suppliers and such information was available to division presidents and the director of purchasing.[321] Officially, Airco's purchasing policy recognized reciprocity only on a ceteris paribus basis, i.e., where price, quality and service were equal.[322] It is evident that Airco's trade relations and other executives practiced at least hortatory reciprocity on several steel companies (who accounted for 16.5 percent of sales in 1968 and 18 percent in 1969) and on other firms from which Airco made substantial purchases and who used or could use Airco products.[323] However, Judge Bonsal, on the basis that Airco's purchases were only a fraction of their sales to four steel companies, and that the government had not introduced into evidence any specific purchase or sale contracts, concluded that the increase in Airco's sales to the steel companies resulted from reciprocal buying. He said "if reciprocal buying did occur, it would probably have had to have been by mutual agreement."[324]

With respect to Airco's sales to FMC Corp., it was shown that Airco had leverage in one particular year. The court was invited to infer from this that a drop in Airco's purchases and an increase in FMC's purchases during the following year were due to coercive reciprocity. There being no accompanying evidence of causality, the invitation was not taken up. Judge Bonsal concluded that "fluctuations in annual purchase and sales figures are by themselves of little probative value...."[325] and this point was reiterated with respect to the Allied Chemical evidence.[326]

However, in other instances, the Department of Justice was able to present considerable evidence of leverage and causality and still failed. With respect to sales to National Distillers, Judge Bonsal found that causality had not been shown because it had not been demonstrated that Airco had "interjected reciprocity considerations" into a particular meeting with National Distillers. But the Justice Department had shown that the necessary sales/purchase data had been compiled shortly before the meeting in question and that Airco officials planned to use this "friendly relationship" to best advantage.[327] That direct evidence is not necessary to prove an antitrust violation is well established. There appeared to be more than sufficient circumstantial evidence in this case for an inference to be drawn, yet the judge refused to so do.

On the basis of this case, following the rules set out in General Dynamics, it appears that unless the Justice Department can come up with written contracts specifying the volume purchased and price paid and a term of the contract indicating that such purchases/sales are conditional upon reciprocal purchase/sales, there can be no violation of Section 1 for reasons of reciprocal dealing.

Fidelity Television, Inc. v.
Federal Communications Commission
(1975)[328]

In 1967 the Justice Department charged General Tire and Rubber, Aerojet-General, A.M., Byers, and R.K.O. General (the last three corporations were subsidiaries of General) with violating Sections 1 and 2 of the Sherman Act through the use of reciprocal dealing. On October 21, 1970 a consent decree was entered in the case enjoining the firms from engaging in reciprocity and requiring them to take certain steps to prevent reciprocal dealing.[329]

This case amounts to a footnote to that action and it involves the decision of the Federal Communications Commission to renew a TV broadcasting license of RKO General. During hearings before the Commission on the renewal application a competing applicant submitted that the application should be denied, because there was evidence that RKO's parent, General Tire and Rubber Co., had used its purchasing power to induce its suppliers to place advertising with RKO. The Commission denied the submission and renewed the license in part because the reciprocity was carried on by the parent rather than the subsidiary corporation. Fidelity appealed arguing, in part, as follows:

> Reciprocity is especially complex in a conglomerate like General Tire because its needs and products are diverse; for example, rubber purchases can be conditioned on advertising sales. Fidelity argues that, for this reason, it was necessary for it to be able to present evidence on reciprocity in the entire General Tire organization, and not simply that which was 'patently germane to RKO's stewardship of KHJ-TV,' as required by the hearing examiner.[330]

The judge noted the existence of the consent decree, that such reciprocity as existed "was ineffective with KHJ," and that "antitrust considerations are only one segment of the Commission's concern with the character of a broadcast applicant."[331] He ruled "that the F.C.C. did not act arbitrarily, capriciously or illegally in refusing to give RKO a demerit or to disqualify it for the reciprocity practices outlined in this record."[332] No reference was made to the Airco decision which was made two months earlier.

## CHAPTER 7

## RECIPROCITY AND CANADIAN COMPETITION POLICY

Reciprocal dealing is not currently included as an offence or a reviewable trade practice under the Canadian Combines Investigation Act.[1] The question under consideration in this chapter is whether or not reciprocity should be (and under what circumstances) considered an illegal restraint of trade and subject to legislative control.

In the proposed Competition Act (Bill C-256) introduced in Parliament in June of 1971,[2] reciprocal buying was included as one of the nine trade practices coming under the jurisdiction of the Competitive Practices Tribunal's civil procedures. Under Section 40(d) reciprocal buying was defined as:

> The practice...whereby a supplier of one commodity or service and a supplier of another commodity or service enter into an arrangement whereby each undertakes to buy all or a substantial part of his requirements of a commodity or service from the other.[3]

The powers of the Tribunal were specified in Sections 37(c) and 37(f). The Tribunal, "where it is satisfied that...a person who is able to influence significantly either the price or volume of a commodity or service supplied in a market has been engaging in or proposes to engage in [reciprocal buying] within that market...by order...prohibit that person from engaging in such practice or from engaging in such practice other than on terms and conditions prescribed in the order...."[4]

Two exemptions were provided by Section 40(2): (1) if the reciprocal buying was between affiliated companies, and (2) if "the practice is reasonably necessary for or incidental to the implementation of a specialization agreement"[5] [as provided for in Section 27].

Fierce opposition by business to Bill C-256 resulted in the government bringing forth Canada's new competition policy in two main stages.[6] Stage I, introduced in November 1973,[7] included as part of the Restrictive Trade Practices Commission's "reviewable matters," four of the nine trade practices that were to come under the Tribunal (tied selling, refusal to deal, exclusive dealing, directed selling--called market restriction).[8] With the exception of reciprocal buying, the remaining trade practices specified in C-256 (price discrimination, promotional allowances, entrenching a monopoly and delivered pricing) are expected to be included in the Stage II amendments to the Combines Investigation Act.[9] Reciprocal buying has apparently been "lost in the shuffle" or awaits further amendments to the Act beyond those

proposed in Stage II. The reason for this is not surprising. Reciprocal buying has simply never been even a potential public policy issue in Canada until the Royal Commission on Corporate Concentration decided to look at it as part of its analysis of conglomerate corporations and the concentration of economic power in general. Our review of the business, trade and academic journals revealed almost no writing on the subject in Canada.[10] With the exception of the testimony of Professor Caves and Narver (and their briefs) to which we have referred, only two other briefs presented to the Royal Commission dealt with the issue of reciprocity. In the Submission of Power Corporation of Canada, Limited three paragraphs are devoted to reciprocity and in that discussion reciprocal buying is confused with the matter of inter-company sales within the Power Corporation "family."[11] The brief states:

> While reciprocity is not an important operating objective for PCC [Power Corporation of Canada], it is only proper and fair that related companies in the group should have an equal opportunity to offer their services to each other provided such services are offered on a competitive basis), and they should be encouraged to do so. Indeed to rule otherwise would be to restrict the market for goods and services for the associated companies, thereby putting them in an unfavourable posture on either a buying or selling basis compared with their competitors.[12]

The second brief was submitted by Ron Huntington, M.P.[13] It quotes the Staff Report of the federal Trade Commission, Economic Report on Corporate Mergers quite extensively and also an article published in Fortune magazine in 1965[14] in support of the contention that, "conglomerate interdependence and forbearance are a hard fact and a reality in Canadian business today."[15] New legislation is advocated to, "Prevent and/or restrict conglomerates that have developed extensive advantage [sic] in the market place through reciprocal trading practices and through cross-subsidization capabilities."[16] On the basis of the rather extensive analysis in this study of legal and economic issues associated with reciprocal dealing in the United States, we are not prepared to draw such a conclusion. Given the total absence of information as to the nature, extent and impact of reciprocal dealing on competition in Canada it is inappropriate to call for strong legislative intervention.[17] Even on the basis of *a priori* theory, as we have indicated in Chapter 5, the case for prohibiting reciprocity is not strong. The circumstances under which reciprocity can be an anti-competitive trade practice would not appear to be widespread. As Professor Bruce Allen has observed:

> ...ultimately, the case against reciprocity, and its alleged foreclosure rests on the inability of the initiator's rivals to retaliate, or of its partners to resist the attractions of extra business or the threat of its withdrawal.... If reciprocity is not simply a species of secret price cutting, and *if*

> those it excludes are helpless to retaliate, a public policy hostile to exclusion must perforce be concerned with reciprocity.[18]

The central question which divides those who urge strong action against reciprocal dealing and those who argue that the practice is pro-competitive or at worst neutral in its impact and hence should not be subject to legislation, is empirical. How frequently do we find firms with extensive, otherwise unutilizable, market power (primarily monopsony power) facing an imperfectly competitive industry from whom it (or an affiliate) both buys from and sells to in significant volume? But the coincidence of these factors is not enough. The firm must decide as a matter of policy to engage in systematic reciprocity. It must gather the appropriate (non-costless) information and make the requisite organizational changes to implement its policy. As Backman observes, "there are very strong reasons--apart from antitrust ...--why conglomerates would not practice recipricity: (1) many products are not susceptible to reciprocity; (2) many other factors influence purchasing decisions; (3) reciprocity can be a costly business practice; and (4) use of profit centers inhibits reciprocity."[19] He concludes that "these factors reduce the area of potentiality and create high barriers to the conversion of potentiality into actuality."[20]

## THE RISE OF RECIPROCITY AS AN ANTITRUST ISSUE IN THE U.S.

Before we set out the policy options for Canada it may be useful to reflect on why reciprocity became an antitrust issue in the United States. As we have indicated in the Introduction, there was great concern in official quarters over the merger boom which reached historic heights in 1967 through 1969. "In 1968, the merger movement was of such magnitude that in a single year nearly 10 percent of all independent manufacturing corporations in the $10 million asset class were acquired."[21] The conglomerate corporation, which accounted for four-fifths of the mergers during the merger boom, did not fit into the well-developed rules which had evolved for horizontal and vertical mergers under Section 7 of the Clayton Act following the Cellar-Kefauver amendments of 1950.[22] New weapons had to be found or forged which would explain why the effect of such conglomerate mergers "may be substantially to lessen competition...."

So much for the "demand" for new antitrust tools. On the supply side a number of factors appear to be relevant. First, when reciprocity was first raised as an unfair method of competition in the 1930's, the Federal Trade Commission had batted 1.000 with respect to coercive reciprocity. Perhaps this long dormant weapon could be raised again and modified to suit the changing

times? Second, in his influential Harvard Law Review article, published in May 1965 just before he became Assistant Attorney General (Antitrust Division), Donald F. Turner had presented a carefully reasoned analysis defining the conditions under which reciprocal dealing could have an anticompetitive impact in terms of a degree of market foreclosure.[23]

With respect to conglomerate mergers in general, Turner urged the antitrust authorities "to proceed with caution." He concluded that his analysis indicated "quite strongly that one cannot support an attack of much greater breadth on conglomerates without entrenching on significant economic and other values, and therefore without an unprecedented reliance on judgements of an essentially political nature."[24]

Finally, Turner stated, "I do not believe Congress has given the courts and the FTC a mandate to campaign against 'superconcentration' in the absence of harm to competition."[25]

With respect to reciprocity Turner said:

> At the outset, it may be stated flatly that reciprocity, even more than the tying arrangements it so closely resembles, has little or nothing to be said in its favor. Competition works satisfactorily only when success rests on lower prices, better quality, better service and the like. Reciprocity distorts the pattern of trade away from the ideal, with no compensating economic advantages.[26]

Obviously, Turner had been persuaded by the language of Commissioner Elman in Consolidated Foods.[27] His article made no reference to the articles by Dean, Harsha, the Hales and Handler.[28] As we indicated in Chapter 5, Turner defined the conditions necessary for reciprocity to have potentially substantial adverse effects. After reviewing the analogy between reciprocity and tying arrangements and the Supreme Court test with respect to the latter,[29] Turner stated:

> ...while we cannot be certain that reciprocity foreclosure will take place [under the conditions he defined] the conditions indicate not only circumstances in which substantial foreclosure is possible, but also circumstances in which some foreclosure is highly probable.[30]

As for the appropriate public policy, Turner argued that the per se rule applied to tying agreements involving a "not insubstantial" amount of commerce would be "wholly inappropriate."[31] Instead, he proposed "that a conglomerate merger should not be outlawed because of possible reciprocity effects unless at least fifteen or twenty percent of a market is made subject to foreclosure."[32] Turner's analysis, then, provided an intellectually respectable

basis for using reciprocity as a weapon to attack conglomerate mergers. A third reason for using the reciprocal dealing argument was its apparent similarity to tying agreements in which the courts had come to declare illegal per se if a "not insubstantial" amount ($500,000 or more) of commerce was involved.[33] If the judges could be persuaded that the two practices were closely analogous, well-defined precedent could be marshalled to judicially condemn reciprocity. Aggressive prosecutors seeking victory are less concerned with the economic rationale of an antitrust weapon than they are with its "salability" to the courts. Less cynically, one can view the raising of reciprocity as an anticompetitive effect as an attempt to explore the limits of antitrust in the tradition of hostility to the concentration of economic and political power. In such a cause, the end often appears to justify the means. Finally, the use of reciprocity as an antitrust weapon can be likened to prosecuting Al Capone for income tax evasion. Despite the best efforts of Elliott Ness et al., Mr. Capone could not be reached for bootlegging, extortion or murder. If jailing Big Al for failing to pay income tax on his ill-gotton gains seems incongrous in light of his more nefarious activities, it had the desired result. Mr. Capone was put out of circulation. So too with the conglomerates. If the Antitrust Division can persuade the requisite number of judges to condemn such mergers because they result in reciprocal dealing (anticompetitive or not) the apparent result is the same. Faced with the unhappy choices between creating an economically indefensible precedent or leaving what was viewed to be a major problem unaddressed, the former is not too hard to defend. Besides, as time went along, a growing body of opinion (Mueller, the FTC, Hausman, etc.[34]) supported the view that reciprocal dealing was an undesirable trade practice which should be (in at least some of its forms) legally condemned. In addition to its role in challenging conglomerate mergers, reciprocity was apparently also seen as a new weapon to belabor firms in long-established oligopolistic industries. Over four-fifths of the consent decrees (see Appendix B) were obtained under Sections 1 and/or 2 of the Sherman Act from prominent firms in oligopolistic industries. Speaking in early 1971, Richard W. McLaren, then Assistant Attorney General (Antitrust Division), said:

> When we initiated a broad attack on this practice in 1969, we learned rather quickly that systematic reciprocity was widespread and affected large segments of the national economy.[35]

In 1969 the Department of Justice obtained two reciprocity-related consent decrees, in 1970 seven and in 1971, ten. It is interesting that, not until the Airco case in late 1974, was there a "pure" reciprocity case (i.e., one not aimed on preventing a conglomerate merger) litigated in the courts by the Department of Justice or the FTC. Apparently the practice of reciprocity was not so valuable to the firms who were challenged that they

would fight to continue it. It is also interesting to point out that if the primary impact of reciprocity is to facilitate indirect price cutting among oligopolists, the latter should probably be in the vanguard of those seeking to have it banned. One might be cynical and suggest that the Nixon Administration chose fairly harmless weapons with which to make a show of antitrust enforcement without seriously challenging the structurally secure oligopolies which account for a significant proportion of the output of United States manufacturing industries.[36] In fairness we should point out that while price-fixing is illegal per se and horizontal mergers which increase concentration only slightly can be successfully attacked under the U.S. antitrust laws, there are no vehicles to attack existing levels of concentration. Apparently, experienced oligopolistic interdependence resulting in price leadership, and other forms of tacit coordination are beyond the reach of the existing statutes.

## A POLICY PARABLE

Reviewing the United States government's approach in conglomerate merger cases one has the feeling of seeing a shambling, myopic giant made fearful by a new threat, the implications of which were as yet unknown, searching about to find a weapon, any weapon, to repel an intruder. One stick that came to hand was called reciprocity. At first the club was called coercive reciprocity. But the intruders kept coming and the fear remained. Longer sticks were raised against the intruder--these were labelled "reciprocity effect," "tacit reciprocity" and even "unilateral reciprocity." More intruders were seen and fear continued to wrack the giant. His search for weapons to beat down the threat widened. Intruders or even the shadows of the intruders had to be stopped on the horizon. He would erect a strong fence right on the horizon. The fact that the new, high, electrically-charged (per se) fence kept out both those bearing gifts and new things of interest to the giant's subjects and the dark intruders worried the giant not at all. He was content. His fear had subsided. There was nothing more to be learned about the behavior of the intruders, where they came from, how many there were or whether some of their actions might be useful to the giant's people. Many of the intruders that had come over the horizon had been beaten off. As time went on fewer intruders presented themselves and the crisis was over.

## POLICY ALTERNATIVES FOR CANADA

It seems reasonable to define three policy alternatives open to Canadian policy makers: (a) do nothing, i.e., continue without any provision in the Combines Investigation Act in respect of

reciprocal dealing; (b) declare certain types of reciprocal dealing (e.g., coercive reciprocity) to be illegal per se; or (c) to treat reciprocity as a reviewable trade practice, as refusal to supply, exclusive dealing, tied selling, market restriction and consignment selling are now treated, and evaluate the practice on a case-by-case basis when the Director of Investigation and Research has reason to believe that grounds exist for the Restrictive Trade Practices Commission to make a remedial order.

Alternative (a) is attractive for a number of reasons. As we have indicated, there is no evidence of any necessity to introduce legislation on reciprocal dealing on the basis of complaints from firms who feel their opportunities to make sales are foreclosed by reciprocity. Second, by doing nothing we are clearly resisting the temptation to generate still more legislation which constrains the area (or potential area) open to business managers. The burden of existing legal constraints (of almost all types) on business has increased markedly in the post-war period. Unless the benefits of additional legislation can be reasonably demonstrated, there should probably be a presumption against more legislation.[37] Third, aside from the lack of complaints regarding reciprocity, there is simply no evidence as to the extent, nature and significance of the practice of reciprocal dealing in Canada. Until some reliable evidence is forthcoming, it seems undesirable to propose legislation to inhibit the practice.

On the other side of the ledger, one could argue that since there are circumstances under which reciprocity can foreclose markets to some degree, we should seek to anticipate such problems before they arise. Therefore, some form of legislation is desirable even in the absence of demonstrated harm.

Alternative (b) is not an attractive choice. Our review of the problem in the United States (empirically and legally) as well as our economic and managerial analysis in Chapter 5, does not indicate that the practice is without virtue and consistently harmful to competition in industries affected by it. But neither is the case for reciprocity so strong that labelling the practice legal per se is appropriate. The social desirability/undesirability of the practice depends largely on the facts of a given situation. Per se rules are not well-suited to trade practices which can be either beneficial or harmful to the competitive process depending upon the particular situation.[38] Skeoch et al. argue that "Canada cannot afford even the few per se, limitist rules applied in the United States; more refined decisions are required that respond more fully to the facts of each case and to the requirements of the Canadian economy."[39]

From our discussion of alternative (a), it should be apparent that if there is insufficient evidence in Canada to justify bringing in <u>any</u> legislation regarding reciprocal dealing, there

is hardly a case for making the practice illegal per se. Besides, making reciprocity illegal per se would be completely out of character for a country which refuses to label overt price fixing illegal per se, but rather requires that such agreements restrict competition "unduly" before characterizing them as illegal restraints of trade.

We move now to Alternative (c). As a trade practice subject to review by the existing Restrictive Trade Practices Commission or by the proposed National Markets Board,[40] reciprocal dealing would be declared neither legal under all circumstances nor illegal per se. On the basis of complaints from businessmen, consumers and government agencies, and on the basis of his own investigations, the Director of Investigation and Research (Bureau of Competition Policy) would have the power to bring cases of reciprocal dealing before the specialized adjudicating body. Currently, Sections 31.2(1) 31.3, 31.4(2) and 31.4(3) of the Combines Investigation Act specify criteria for determining whether the reviewable trade practices should be subject to an order of the RTPC. Skeoch et al. set out five general objectives toward which decisions of the proposed National Markets Board would be directed.[41] Obviously, criteria for the evaluation of specific cases of reciprocal dealing would have to be a part of any new legislation. Judge Austin in the ITT-Canteen case proposed a three part test for reciprocal dealing resulting from a merger:

- the merger must significantly increase the opportunities for reciprocal dealing;
- there must be a reasonable probability that the opportunities will be exploited;
- the resulting reciprocal dealing must have a tendency to substantially lessen competition.[42]

Steiner argues that if the antitrust authorities are going to set up guidelines for reciprocity, they should proceed sequentially by identifying:

- the opportunities for reciprocity;
- the likelihood of particular forms of reciprocity being practiced;
- the probable effects of such reciprocity in each of the markets involved;
- the consequences of such effects.[43]

In Chart 7 on page 167 we have generalized both of these concepts and provide a framework for the sequential analysis of reciprocal dealing cases. Below each stage of the analysis we have indicated some of the important issues which the specialized adjudicating body would have to consider in evaluating each case. A more comprehensive discussion of these factors was given in Chapter 5. It is important to note that the framework is sufficiently general to deal with reciprocity that does not

C H A R T 7

SEQUENTIAL ANALYSIS OF RECIPROCAL DEALING

Merger/ Acquisition

Internal Diversification by a Single Firm

| Simple Reciprocity Potential | Reciprocity Potential backed by Market Power | Probability of Exercising Market Power in Form of Reciprocity | Degree of Adverse Economic Impact | Effectiveness of Penalty or Remedy |
|---|---|---|---|---|
| • appropriate input/output relationship (contact points)? | • otherwise utilizable monopsony power? | • benefits costs to the firm--impact on sales force, purchasing policy? | • extent of market foreclosure? | • conduct on structural remedy? |
| • relatively undifferentiated produce (a number of reasonably close substitutes)? | • willingness to transfer already utilized market power? | • company policy? | • indirect price cutting? | • social cost of remedy vs social benefit ? |
| • excess capacity, high fixed costs and low marginal costs? | • market structure of supplier industry and that in which affiliates operate? | • requisite information on sales/purchases? | • impact on concentration? | • efficiency objectives vs ethical ones, e.g., fair competition, protection of competitors rather than competition? |
| • transaction costs, reduction of uncertainty savings? | • asymmetry of competitor's position in relevant markets? | • organizational structure, i.e., M-form vs U-form organizations? | • impact on barriers entry? | |
| | | • previous antitrust history? | • countervailing power by suppliers? | |

arise from a merger. Reciprocity should be viewed as a trade practice as are a wide variety of other trade practices (e.g., price discrimination, predatory pricing, tying agreements, etc.) which arise in imperfectly competitive industries and whose social desirability depends on the consequences they produce.

Alternative (c) clearly fits in with current thinking in Canada with respect to trade practices whose impact is ambiguous. If the extent, nature and significance of reciprocal dealing in Canada is in fact comparable to the United States (although we have no evidence on these points) then Alternative (c) represents a pragmatic policy approach. However, given the absence of information regarding the practice of reciprocal dealing in Canada, the adoption of Alternative (c) would represent anticipatory legislative action. The desirability of anticipating such an economic problem is an issue about which reasonable people can differ.

NOTES

CHAPTER 1

INTRODUCTION

[1]Cited in A.W. Gouldner, "The Norm of Reciprocity," American Sociological Review, Vol. 25, 1961, p. 161.

[2]Cited in Robert M. Hausman, "Reciprocal Dealing and the Antitrust Laws," Harvard Law Review, Vol. 77, March 1964, p. 875.

[3]Gouldner, p. 171.

[4]Joel Dean, "Economic Aspects of Reciprocity, Competition and Mergers, Antitrust Bulletin, Vol. 8, Sept.-Oct., 1963, p. 845.

[5]James M. Ferguson, "Tying Arrangements and Reciprocity; An Economic Analysis," Law and Contemporary Problems, Vol. 30, No. 3, Summer, 1965, pp. 552-580, as reprinted in W. Sichel (ed.), Industrial Organization and Public Policy: Selected Readings (Boston, Houghton-Mifflin, 1967) p. 304.

[6]"Corporate Merger Trends," Address by Attorney General John N. Mitchell before the Georgia Bar Association, June 6, 1969, as reprinted in CCH, Trade Regulation Reports,1972, Par. 50107, p. 55125.

[7]*Ibid.*, p. 55125.

[8]*Ibid.*, p. 55126.

[9]*Ibid.*, pp. 55126-55127.

[10]Published in CCH, Trade Regulation Reports, 1971, Par. 4510.

[11]Mitchell, p. 55128.

[12]As cited in Phillip I. Blumberg, The Megacorporation in American Society (Englewood Cliffs, Prentice-Hall, 1975),p. 50.

[13]CCH, Trade Regulation Reports, 1971, Par. 4510, pp. 6687-6888.

[14] *Ibid.*, pp. 6888-6889.

[15] *Task Force Report on Antitrust Policy* (Phil C. Neal, Chairman), published in CCH, *Trade Regulation Reports*, 1969, Supplement to No. 415, May 26, 1969, p. III-1.

[16] *Ibid.*, p. III-7.

[17] *Ibid.*, p. 3. Apparently unhappy with the Neal Report, President Nixon commissioned his own task force under the chairmanship of Professor George J. Stigler. The *Report of the Task Force on Productivity and Competition* (published in *Antitrust Law & Economics Review*, Vol. 2, No. 3, Spring 1969, pp. 13-52) took issue with the Department of Justice's "Merger Guidelines" and its attack on conglomerate mergers. It stated, "The present 'Merger Guidelines' impose stringent restrictions upon the relative sizes permitted to companies which desire to merge. The impact of these percentages is reinforced by a definition of the market (within which shares of companies are reckoned) so loose and unprofessional as to be positively embarrassing. We propose to reverse this emphasis: not to tell companies which mergers are forbidden, but which are permitted." (p. 27). "Our Task Force is of one mind on the undesirability of an extensive and vigorous policy against vertical mergers: vertical integration has not been shown to be presumptively non-competitive and the 'Guidelines' err in so treating it." (p. 29). "We seriously doubt that the Antitrust Division should embark upon an active program of challenging conglomerate enterprises on the basis of nebulous fears about size and economic power.... Vigorous action on the basis of our present knowledge is not defensible" (p. 31). The Task Force's views on reciprocity are outlined in Chapter 2.

[18] See Appendix A.

[19] See Jesse W. Markham, "Antitrust and the Conglomerate: A Policy in Search of a Theory," *St. John's Law Review*, Vol. 44, Special Edition, 1970, pp. 282-291, especially pp. 283-286.

[20] J. Fred Weston, "The Nature and Significance of Conglomerate Firms" (*St. John's Law Review*, Vol. 44, Special Edition, 1970, pp. 66-80) outlines several bases of attack on conglomerate mergers: predatory pricing and cross-subsidization, the "deep-pocket" theory, effects on barriers to entry, and reciprocity. See also John Vanderstar, "Conglomerate Mergers: The Developing Antitrust Guidelines," *St. John's Law Review*, Vol. 44, Special Edition, 1970, pp. 596-612.

[21] John T. Loughlin, "A Lawyer's View of Conglomerate Mergers," *St. John's Law Review*, Vol. 44, Special Edition, 1970, p. 682.

Loughlin cited the lack of enthusiasm of Assistant Attorney General (Antitrust Division) Donald F. Turner for challenging conglomerate mergers in contrast to the aggressive approach endorsed in the Staff Report of the Federal Trade Commission, Economic Report on Corporate Mergers (Washington, D.C., 1969). Turner's views were well known before he was appointed to head the Antitrust Division, i.e., Donald F. Turner, "Conglomerate Mergers and Section 7 of the Clayton Act," Harvard Law Review, Vol. 78, No. 7, May 1965, pp. 1313-1395. Turner was with the Department of Justice from June 1965 to May 1968. A critique of Turner at the Antitrust Division is given in Mark J. Green et al., The Closed Enterprise System (New York, Bantam Books, 1972), pp. 82-96.

[22] Loughlin, p. 683.

[23] Willard F. Mueller, "Summary of the Economic Report on Corporate Mergers," Statement before the Subcommittee on Antitrust and Monopoly of the Committee on the Judiciary, U.S. Senate, November 4, 1969, as reprinted in Staff of the Bureau of Economics, Federal Trade Commission, Economic Papers 1966-1969 (Washington, D.C., USGPO, 1970), p. 287.

[24] Mueller, pp. 286, 287.

[25] See Footnote 17.

[26] In mid-1969 Richard McLaren, Assistant Attorney General, Antitrust Division, is quoted as saying, "I think in the past two or three years things have gotten beyond anything the economists used to talk about." (Business Week, June 21, 1969, p. 122). Business executives whose long established firms were the subject of the new conglomerates attention were often opposed to being taken over. They urged antitrust action to prevent such take-overs. See, for example, Tom O'Hanlon, "Goodrich's Four-Ply Defense," Fortune, July 1969, pp. 110-113, 182-184, 189.

[27] "Separate Statement of Robert H. Bork," Task Force Report on Antitrust Policy, as reprinted in CCH, Trade Regulation Reports, Supplement No. 415, May 26, 1969, pp. 4-A, 5-A. In contrast, Richard McLaren, in charge of the Antitrust Division from 1969 through 1971, identified a number of anticompetitive effects of conglomerate mergers including (1) elimination of potential entrants; (2) increased barriers to entry in a concentrated market or entrenchment of a dominant firm's position; (3) creation of the opportunity to engage in reciprocal dealing; (4) dilution of inter-industry competitive zeal for fear of retaliation in different product areas by other inter-industry firms; (5) reduction in the number of independent firms conducting research

and utilizing competitive innovation. (As cited in Douglas V. Rigler, "Conglomerate Mergers - Reciprocity, Real and Potential, as a Basis for Attack," St. John's Law Review, Vol. 44, Special Edition, 1970, p. 581".

[28] See the exhaustive analysis of vertical restraints in Richard S. Markovits, "Tie-ins, Reciprocity, and the Leverage Theory," Yale Law Journal, Vol. 76, 1967, pp. 1397-1472, and "Tie-ins, Reciprocity, and the Leverage Theory, Part II: Tie-ins, Leverage and the American Antitrust Laws," Yale Law Journal, Vol. 80, No. 2, December 1970, pp. 195-315. The title of these articles is misleading; they deal entirely with tie-in selling arrangements.

[29] Richard W. McLaren, "Reciprocity: The 'Hobgoblin' of the Antitrust Critics," ABA Antitrust Law Journal, Vol. 39, 1970, pp. 226-227.

[30] Ibid.

[31] Ibid.

[32] Roland W. Donnem, "The Antitrust Attack on Reciprocity and Reciprocity Effect," ABA Antitrust Law Journal, Vol. 38, 1969, p. 637. Reciprocity effect is defined in Chapter III. The same point was made by Lionel Kestenbaum, then Chief, Evaluation Section, Antitrust Division, two years earlier in his "Is Reciprocity Illegal, Immoral or Just Fattening?" The Record of the Association of the Bar of the City of New York, Vol. 1967, p. 579.

[33] U.S. v. Airco Inc., Federal Supplement, Vol. 386, 1974, pp. 915-926.

[34] Thomas E. Kauper, "Antitrust Bogeyman," address before the New York State Bar Association, January 24, 1973, reprinted in CCH, Trade Regulation Reports, 1973 Par. 50160, p. 55278, p. 55278. Mr. Kauper noted that the Department had brought 23 civil cases "against major companies employing systematic reciprocity" and that "the Department could not rule out criminal prosecution in this area" (p. 55278).

[35] U.S. v. General Dynamics, Federal Supplement, Vol. 258, 1966, 36 at p. 57.

[36] We do not discuss in detail the three cases which were decided under Section 5 of the Federal Trade Commission Act in the 1930's (Waugh Equipment (1931), Mechanical Manufacturing (1932), and California Packing (1937) because they have had little bearing on contemporary U.S. jurisprudence. There have been no further prosecutions or private civil actions stemming from violations of Section 5. We begin in 1963 because there were no reciprocity cases, other than the ones in the 1930's, prior to that time.

NOTES

CHAPTER 2

## THE SIGNIFICANCE OF RECIPROCAL DEALING SURVEY OF THE CONFLICTING VIEWS

[1]Report of the Task Force on Productivity and Competition as reprinted in Antitrust Law & Economics Review, Vol. 2, No. 3, Spring 1969, pp. 30-31. The Report clearly reflects the views of Professor George J. Stigler, the Chairman of the Task Force ("Working Paper IV: Reciprocity," published with the Report, pp. 51-52) and members Ronald Coase ("Working Paper II: The Conglomerate Merger," pp. 45-46), and Ward S. Bowman (e.g., R. Bork and W.S. Bowman, "The Crisis on Antitrust," Fortune, December, 1963, and Ward S. Bowman, "Working Paper I: Vertical Integration by Merger or by Contract," pp. 41-44).

[2]James M. Ferguson, "Tying Arrangements and Reciprocity: An Analysis," Law and Contemporary Problems, Vol. 30, No. 3, Summer 1965, as reprinted in W. Sichel (ed.) Industrial Organization and Public Policy: Selected Readings, Boston, Houghton Mifflin Co., 1967, p. 302.

[3]Ibid., p. 308.

[4]Ibid., p. 302.

[5]See Chapter 6.

[6]As quoted in Howard Adler, "Merger Doctrine: Some Emerging Issues," Loyola University Law Review, Vol. 3, 1970, p. 286.

[7]Ferguson, pp. 303-308.

[8]Ibid., p. 315.

[9]Joel Dean, "Economic Aspects of Reciprocity, Competition and Mergers," Antitrust Bulletin, Vol. 8, Sept.-Oct., 1963, p. 846. See also p. 851.

[10]Ibid.

[11]Werner Sichel, "Business Reciprocity: An Unsettled Antitrust Issue," Antitrust Bulletin, Vol. 13, 1968, p. 652.

[12] *Ibid.*, p. 658.

[13] Staff Report of the Federal Trade Commission, *Economic Report on Corporate Mergers* (Washington, D.C., 1969), p. 328. The Report clearly reflects the views of Willard Mueller, at that time the FTC's Director of the Bureau of Economics. See also his "The Rising Economic Concentration in America: Reciprocity Conglomeration and the New American 'Zaibatsu' System II," *Antitrust Law & Economics Review*, Vol. 4, No. 4, Summer 1971, pp. 91-104. See also Mary Gardiner Jones and Edward J. Heiden, "Conglomerates: The Need for Rational Policy Making," *St. John's Law Review*, Vol. 44, Special Edition 1970, pp. 251-253.

[14] Staff Report, p. 329.

[15] *Ibid.*

[16] *Ibid.*, p. 330

[17] *Ibid.*

[18] *Ibid.*, pp. 330-331.

[19] Donald F. Turner, "Conglomerate Mergers and Section 7 of the Clayton Act," *Harvard Law Review*, Vol. 78, 1965, p. 1387. See also Macdonald Flinn, "Reciprocity and Related Topics under the Sherman Act," *ABA Antitrust Law Journal*, Vol. 37, 1967, p. 166, and Lewis D. Asper, "Reciprocity, Purchasing Power and Competition," *Minnesota Law Review*, Vol. 48, 1964, p. 529.

[20] Richard A. Solomon, "The Concentric Merger and Section 7 of the Clayton Act," *St. John's Law Review*, Vol. 44, Special Edition, 1970, pp. 574-575.

[21] Robert M. Hausman, "Reciprocal Dealing and the Antitrust Laws," *Harvard Law Review*, Vol. 77, March 1964, p. 879.

[22] *Ibid.*

[23] *Ibid.*

[24] *Ibid.*, pp. 879-880.

[25] *Ibid.*, p. 880.

[26] *Ibid.*

[27] *Ibid.*, p. 882.

[28] Federal Trade Commission v. Consolidated Foods Corporation, *Supreme Court Reporter*, Vol. 85, 1965, 1220 at p. 1221.

[29] *Ibid.*, p. 1222.

[30] Richard A. Posner, *Economic Analysis of Law* (Boston: Little, Brown & Co., 1972), p. 126.

[31] The same point is reiterated by L.W. Keeshan "Conglomerate Mergers and the Theory of Reciprocity," *Stanford Law Review*, Vol. 22, 1970, pp. 821-822.

[32] Richard A. Posner, "Conglomerate Mergers and Antitrust Policy: An Introduction," *St. John's Law Review*, Vol. 44, Special Edition, 1970, pp. 530-531.

[33] J.P. Anderson, "Reciprocal Dealing," *Yale Law Journal*, Vol. 76, 1967, p. 1025.

[34] *Ibid.*

[35] *Ibid.*, pp. 1025-1026.

[36] *Ibid.*, pp. 1026-1027.

[37] *Ibid.*, p. 1029.

[38] Keeshan, pp. 819-821.

[39] *Ibid.*, pp. 821-822.

[40] *Ibid.*, pp 815-816

[41] *Ibid.*, p. 823.

[42] Quoted in J. Weingarten, "Reciprocity Under Fire," *Dun's Review*, Vol. 92, No. 3, September 1968, p. 35.

[43]Quoted in "Claudia H. Deutsch, "Reciprocal Trade: It's Still an Issue," Purchasing, November 6, 1973, p. 41.

[44]Quoted in "Reciprocity, Dangerous Selling Tool Winning New Users," Sales Management, May 20, 1960, p. 41.

[45]Lionel Kestenbaum, "Is Reciprocity Illegal, Immoral or Just Fattening?" The Record of the Association of the Bar of the City of New York, Vol. 22, p. 576.

[46]Ibid., p. 577.

[47]Ibid., p. 578.

[48]Ibid.

[49]Quoted in Weingarten, p. 37.

[50]Quoted in Deutsch, p. 41.

[51]Quoted in Malcolm C. Neuhoff and G. Clark Thompson, "Reciprocity--Many Practice, Few Favor," Conference Board Business Record, March 1954, p. 107.

[52]Jack R. Dauner, "The Attitude of the Purchasing Agent Toward Reciprocity," Journal of Purchasing, Vol. 3, August 1967, p. 13.

[53]Quoted in "Selling's Buddy System," Sales Management, Vol. 98, February 1, 1967, p. 29.

[54]Quoted in Sales Management, May 20, 1960, p. 41.

[55]Quoted in Neuhoff and Thompson, p. 106.

[56]Quoted in Dauner, p. 13.

[57]Staff Report of the Federal Trade Commission, p. 351.

[58]Frank Robert Finney, "Reciprocal Buying and Public Policy" (unpublished Ph.D. dissertation, University of California, Berkeley, Faculty of Business Administration, 1968), p. 55.

[59] Howard T. Lewis, "The Present Status of Reciprocity as a Sales Policy," Harvard Business Review, Vol. 16, 1938, p. 313.

[60] Neuhoff and Thompson, p. 107.

[61] Sales Management, May 20, 1960, p. 41.

[62] Quoted in Dauner, p. 13.

[63] Ibid.

[64] Quoted in Sales Management, May 20, 1960, p. 41.

[65] Quoted in Neuhoff and Thompson, p. 108.

[66] Ibid.

[67] Ibid.

[68] Ibid.

[69] Dean S. Ammer, "Realistic Reciprocity," Harvard Business Review, Vol. 40, Jan.-Feb., 1962, p. 122. (Emphasis in the original.)

[70] Ammer, pp. 122-123. The variety of difficulties of operating a reciprocity policy are discussed in Robert E. Weigand, "The Problems of Managing Reciprocity," California Management Review, Vol. 16, Fall 1973, pp. 40-48.

[71] Sales Management, February 1, 1967, p. 27.

[72] Ibid.

[73] J. Weingarten, p. 37.

[74] Milton Handler, pp. 656-657.

[75] Peter O. Steiner, Mergers, Motives, Effects and Policies (Ann Arbor, University of Michigan Press, 1975), Chapter 9, pp. 218-254.

[76] *Ibid.*, p. 252.

[77] Jones and Heiden, pp. 253-254.

[78] Bruce T. Allen, "Industrial Reciprocity: A Statistical Analysis," *Journal of Law and Economics*, Vol. 17, No. 2, October, 1975, pp. 507-520.

[79] *Ibid.*, p. 510.

[80] *Ibid.*, p. 511.

[81] *Ibid.*, pp. 512-513.

[82] *Ibid.*, p. 518.

[83] *Ibid.*, p. 519.

[84] *Ibid.*

[85] Jones and Heiden, p. 254. See also John T. Loughlin, "A Lawyer's View of Conglomerate Mergers," *St. John's Law Review*, Vol. 44, Special Edition, 1970, p. 682.

NOTES

CHAPTER 3

RECIPROCAL DEALING: THE PROBLEM OF DEFINITION AND CLASSIFICATION

[1]Peter O. Steiner, Mergers, Motives, Effects and Policies (Ann Arbor, University of Michigan Press, 1975), Chapter 9, pp. 223-225.

[2]James M. Ferguson, "Tying Arrangements and Reciprocity: An Economic Analysis," Law and Contemporary Problems, Vol. 30, No. 3, Summer 1965, as reprinted in W. Sichel (ed.), Industrial Organization and Public Policy: Selected Readings (Boston, Houghton-Mifflin Co., 1967), p. 302.

[3]Werner Sichel, "Business Reciprocity: An Unsettled Antitrust Issue," Antitrust Bulletin, Vol. 13, 1968, p. 650.

[4]George W. Stocking and Willard F. Mueller, "Business Reciprocity and the Size of Firms," Journal of Business, Vol. 30, No. 2, April 1957, p. 74.

[5]J.H. Westing, I.V. Fine, G.J. Zenz, Purchasing Management: Materials in Motion (New York, John Wiley & Sons, 1969), 3rd ed., p. 106.

[6]Ibid.

[7]Robert M. Hausman, "Reciprocal Dealing and the Antitrust Laws, Harvard Law Review, Vol. 77, March 1964, p. 873.

[8]Federal Trade Commission Decisions, Vol. 62, 1963, 929 at p. 948.

[9]See E. Houston Harsha, "The Conglomerate Merger and Reciprocity--Condemned by Conjecture?" Antitrust Bulletin, Vol. 9, 1964, pp. 201-230.

[10]Antitrust and Trade Regulation Today, Second Edition (Washington, D.C., Bureau of National Affairs, 1966), p. 22 (originally published in Antitrust and Trade Regulation Reporter, 6/1/65).

[11] L.W. Keeshan, "Conglomerate Mergers and the Theory of Reciprocity," Stanford Law Review, Vol. 22, 1970, p. 814. In his testimony before the Royal Commission on Corporate Concentration (Vancouver, November 14, 1975) Professor John Narver described coercive reciprocity as follows:

> ...when a firm, through its purchasing power, commands the attention of another firm and, in effect, orders the other firm to purchase in turn from it. This turns on the existence of market power, in effect, that firm A has such a command over the purchase of a particular product that it can insist on the attention and, if you want, compliance of other firms that, insofar as possible, must [from] here on purchase their requirements from the given firm (pp. 597-598).

[12] Stephen L. Dunne, "Reciprocity: The Hazards of Backscratching," Willamette Law Journal, Vol. 11, 1975, p. 160.

[13] Ibid.

[14] Edgar E. Barton, "Reciprocity," Business Lawyer, Vol. 21, April 1966, p. 614.

[15] Ferguson, p. 314.

[16] Keeshan, pp. 815-816. Business Management (Vol. 37, January 1970, p. 32) provides a very brief summary of the legal definition of coercive reciprocity: "It must be proved that a corporation has(1) the necessary purchasing leverage; (2) the facilities and 'predisposition' to apply that leverage and (3) purchase agreements which reflect the application of that leverage because they are not based solely on considerations of cost, quality and service." A comprehensive discussion is contained in Chapter 6.

[17] See, for example, Joel Dean, "Economic Aspects of Reciprocity, Competition and Mergers," Antitrust Bulletin, Vol. 8, Sept.-Oct. 1963, pp. 846, 851.

[18] Steiner, p. 223.

[19] Ibid.

[20] Waugh Equipment et al., Federal Trade Commission Decisions, Vol. 15, 1931, pp. 232-248.

[21] *Ibid.*, p. 236.

[22] *Ibid.*, p. 242.

[23] *Ibid.*, pp. 246-247.

[24] Mechanical Manufacturing et al., *Federal Trade Commission Decisions*, Vol. 16, 1932, pp. 67-76.

[25] The FTC decision in the *Mechanical Manufacturing* case indicates that in 1929 Mechanical sold 4192 sets of draft gears. In the *Waugh Equipment* case (*ibid.*, pp. 242-243) it is noted that in 1924 railroads placed orders for 144,000 freight cars, "which was the largest building program for any year since 1916 except 1922." In 1925 the number was approximately 93,000 and in 1926 it was approximately 67,000--"the lowest number since 1921." For 1929, therefore, we estimated a total market of 80,000.

[26] Steiner, p. 225.

[27] Barton, p. 64.

[28] Reed Moyer, "Reciprocity: Retrospect and Prospect," *Journal of Marketing*, Vol. 34, October 1970, p. 47.

[29] Jules Backman, "Conglomerate Mergers and Competition," *St. John's Law Review*, Vol. 44, Special Edition, 1970, p. 93.

[30] F.R. Finney, "Reciprocity and Public Rolicy," *Antitrust Law & Economics Review*, Vol. 2, No. 4, Summer 1969, p. 98.

[31] *Ibid.*

[32] Cited in Barton, p. 613. The original is *Federal Supplement*, Vol. 118, 621 at p. 633 (S.D.N.Y. 1953).

[33] See Finney, pp. 104-106 regarding the use of a trade relations department to practice systematic reciprocity. See also Lionel Kestenbaum "Is Reciprocity Illegal, Immoral or Just Fattening?" *The Record of the Association of the Bar of the City of New York*, Vol. 22, 1967, pp. 578-581 and David F. Zoll, "The Making and Selling of an Antireciprocity Program," *ABA Law Notes*, Vol. 9, Fall 1972, pp. 2-3 for two enforcement officials' views as to what constitutes systematic reciprocity.

[35] Ferguson, p. 314.

[36] *Ibid*. p., 301, see also Harsha, p. 208.

[37] Harsha, p. 208.

[38] Steiner, p. 224.

[39] Wallace Kaapcke, "Comments," in Walker B. Comegys (Symposium Chairman), "United States v. General Tire and Rubber Company: Intracorporate Conspiracy and Sherman Act Reciprocity," *ABA Antitrust Law Journal*, Vol. 36, 1967, p. 109.

[40] A.W. Gouldner, "The Norm of Reciprocity," *American Sociological Review*, Vol. 25, 1961, pp. 161-179.

[41] Quoted in "Selling's Buddy System," *Sales Management*, February 1, 1967, p. 29.

[42] See Finney, pp. 103-106.

[43] Edward McCreary Jr. and Walter Guzzardi Jr., A Customer Is a Company's Best Friend," *Fortune*, June 1965, p. 182.

[44] *Ibid*., p. 192.

[45] John D. Garrison and Arthur B. Hooker, "Trade Relations: Some Misconceptions and Realities," *Business Lawyer*, Vol. 22, July 1967, p. 1146.

[46] *Ibid*.

[47] Donald F. Turner, "Conglomerate Mergers and Section 7 of the Clayton Act," *Harvard Law Review*, Vol. 78, No. 7, May 1965, p. 1390 states, "informal reciprocity pressures through a conglomerate company's salesmen, whether sanctioned or not, are probably not only common but extraordinarily hard to detect; and they are likely to persist whenever the market structure is conducive to them."

[48] Steiner, p. 223.

[49] John Vanderstar, "Conglomerate Mergers: The Developing Antitrust Guidelines," St. John's Law Review, Vol. 44. Special Edition, 1970, p. 600.

[50] Steiner, p. 224.

[51] Testimony of Dr. John Narver, Royal Commission on Corporate Concentration, Vancouver, November 14, 1975, p. 598 (transcript).

[52] Ibid.

[53] Keeshan, p. 815.

[54] Ibid., p. 818.

[55] Ibid., pp. 818-819

[56] Ibid., pp. 819-821.

[57] Dunne, p. 161.

[58] Ferguson, p. 301, Harsha, p. 208.

[59] Kaapcke, p. 106.

[60] Milton Handler, "Gilding the Philosophic Pill--Trading Bows for Arrows," Columbia Law Review, Vol. 66, 1966, pp. 1-11, as reprinted in Milton Handler, Twenty-five Years of Antitrust, Vol. I (New York, Mathew Bender, 1973), p. 656.

[61] Ibid., p. 660.

[62] Ibid.

[63] Brief on Behalf of the Federal Trade Commission, p. 24, Footnote 11.

[64] Federal Supplement, Vol. 258, 1966, 36 at p. 59.

[65] Ibid., p. 66.

[66] *Ibid.*

[67] Lawrence Williams, "Comments," in Comegys (Footnote 39), p. 116.

[68] Roland W. Donnem, "The Antitrust Attack on Reciprocity and Reciprocity Effect," *ABA Antitrust Law Journal*, Vol. 38, 1969, p. 637. At the time it was written, the author was a senior official in the Department of Justice. Backman (p. 94) remarks, "The real problem, however, arises not when coercion is present, but when it is only implied by the market setting. It makes no sense to say that a company should not buy from a supplier who is also a good customer."

[69] *Federal Trade Commission Decisions*, Vol. 62, 1963, p. 952.

[70] Dunne, p. 161.

[71] Ferguson, pp. 301-302; Harsha, p. 208.

[72] Ferguson, p. 302. Earle W. Kintner, ("The Anatomy of Reciprocity," *American Bar Association Journal*, Vol. 56, 1976 pp. 232-236), is of the same opinion. "Unilateral action may well be an attempt at reciprocity, but it can never logically constitute actual reciprocity because there is no accomplished mutual arrangement." He continues..."There is the further fact the purchasing practices in question must be capable of stimulating reciprocity" (p. 233).

[73] Steiner, p. 225; see also Bernard E. Harvith, "Reciprocity and the Federal Antitrust Laws," *Washington Law Review*, Vol. 40, 1965, p. 138

[74] Backman, pp. 94-95.

[75] J. Fred Weston, "The Nature and Significance of Conglomerate Firms," *St. John's Law Review*, Vol. 44, Special Edition, 1970, pp. 75-76.

[76] A. Krash, "The Legality of Reciprocity under Section 7 of the Clayton Act," *Antitrust Bulletin*, Vol. 9, 1964, pp. 98-99.

[77] Harvith, pp. 138-139.

[78]Vanderstar, p. 600.

[79]Keeshan, p. 814.

[80]*Ibid*.

[81]*Ibid*., p. 817.

[82]*Ibid*., p. 818.

[83]ITT (Grinnell and Hartford), *1969 Trade Cases*, Par. 72943; ITT-Grinnell, *1971 Trade Cases*, Par. 73424; ITT-Canteen, *1971 Trade Cases*, Par. 73619.

[84]Weston, p. 76.

[85]*Federal Supplement*, Vol. 218, 1963, 530 at p. 552.

[86]John R. Hicks, "Annual Survey of Economic Theory: The Theory of Monopoly," *Econometrica*, Vol. III, January 1935, p. 8.

[87]Stocking and Mueller, p. 75.

[88]*Federal Supplement*, Vol. 218, 1963, 530 at p. 552.

[89]Betty Bock, "Mergers and Reciprocity," *Conference Board Record*, Vol. II, July 1965, p. 29.

[90]*Ibid*., p. 28.

NOTES

CHAPTER 4

THE EXTENT OF RECIPROCAL DEALING:
THE EMPIRICAL EVIDENCE

[1]Leonard Sloane, "Reciprocity: Where Does the P.A. Stand?" Purchasing, Vol. 51, November 20, 1961, p. 70.

[2]"Swapping Business," Wall Street Journal, December 4, 1963, p. 1, Col. 6.

[3]Address by George Miron, Assistant Chief, General Litigation Section, Antitrust Division, Department of Justice, at a meeting of the Trade Relations Association, September 18, 1963, p. 1, in Trade Regulation Reporter, 1963, Par. 50206.

[4]Milton Handler, "Gilding the Philosophic Pill--Trading Bows for Arrows," Columbia Law Review, Vol. 68, 1966, pp. 1-11 as reprinted in Milton Handler, Twenty-Five Years of Antitrust, Vol. 1 (New York: Mathew Bender, 1973), Ch. 20, pp. 653-654.

[5]Ibid., p. 654.

[6]Ibid.

[7]Ibid., pp. 654-655.

[8]Ibid., p. 656.

[9]Adam Smith, The Wealth of Nations (orig. 1776; New York: Modern Library edition, 1937), p. 460 (edited by Edwin Cannan).

[10]Frank Robert Finney, "Reciprocal Buying and Public Policy" (unpublished Ph.D. dissertation, University of California, Berkeley, Faculty of Business Administration, 1968), 197 pages.

[11]Ibid., p. 34.

[12]Ibid., pp. 34-35.

[13]Ibid., p. 35.

[14] *Ibid.*, p. 36.

[15] *Ibid.*, p. 65. (Emphasis in the original.)

[16] *Ibid.*

[17] *Ibid.*, p. 66.

[18] *Ibid.*, p. 43.

[19] *Ibid.*, p. 44.

[20] *Ibid.*, p. 36.

[21] *Ibid.*, p. 67.

[22] *Ibid.*, p. 68.

[23] *Ibid.*, p. 69.

[24] *Ibid.*, p. 73.

[25] *Ibid.*, pp. 39-42.

[26] *Ibid.*, p. 42.

[27] Interstate Commerce Commission, "In the Matter of Reciprocity in Purchasing and Routing," *Interstate Commerce Commission Reports*, Vol. 188, 1932, pp. 417-435.

[28] *Ibid.*, p. 419.

[29] *Ibid.*, p. 420.

[30] Waugh Equipment et al., *Federal Trade Commission Decisions*, Vol. 15, 1931, pp. 232-248. The early cases are discussed in H.D. Smith, "Business Reciprocity and the Antitrust Laws," *Notre Dame Lawyer*, Vol. 39, 1964, pp. 187-191.

[31] Mechanical Manufacturing et al., *Federal Trade Commission Decisions*, Vol. 16, 1932, pp. 67-76.

[32]Interstate Commerce Commission, p. 420.

[33]*Ibid.*, p. 422.

[34]*Ibid.*

[35]*Ibid.*, p. 424.

[36]*Ibid.*, pp. 424-425.

[37]*Ibid.*, p. 433.

[38]*Ibid.*, pp. 433-434.

[39]*Ibid.*, p. 434.

[40]See Footnotes 30 and 31. The third case was California Packing Corporation, et al., *Federal Trade Commission Decisions*, Vol. 25, 1937, pp. 379-401.

[41]Howard T. Lewis, "The Present Status of Reciprocity as a Sales Policy," *Harvard Business Review*, Vol. 16, 1938, pp. 299-313.

[42]*Ibid.*, p. 299.

[43]*Ibid.*

[44]*Ibid.*, p. 300.

[45]*Ibid.*, p. 301.

[46]*Ibid.*

[47]*Ibid.*

[48]*Ibid.*, p. 305.

[49]*Ibid.*

[50]*Ibid.*

[51] *Ibid.*, p. 311.

[52] *Ibid.*, p. 312.

[53] Malcolm C. Neuhoff and G. Clark Thompson, "Reciprocity--Many Practice, Few Favor," *Conference Board Business Record*, March 1954, pp. 106-109.

[54] *Ibid.*, p. 106.

[55] *Ibid.*, p. 107.

[56] *Ibid.*

[57] *Ibid.*

[58] *Ibid.*, pp. 107-108.

[59] *Ibid.*, p. 108.

[60] *Ibid.*

[61] *Ibid.*, p. 106.

[62] *Ibid.*, p. 108.

[63] *Ibid.*, p. 109.

[64] George W. Stocking and Willard F. Mueller, "Business Reciprocity and the Size of Firms," *Journal of Business*, Vol. 30, No. 2, April 1957, pp. 73-95.

[65] *Ibid.*, pp. 80-85.

[66] *Ibid.*, pp. 85-88.

[67] *Ibid.*, pp. 88-89.

[68] *Ibid.*, pp. 89-92. We should point out that the indictment filed by the U.S. Department of Justice in April 1961 and the civil complaint filed in January 1963 charging GM with monopolization in the sale of diesel electric locomotives partly

through the use of reciprocal selling was later dropped. This case is discussed at some length in Thomas G. Marx, "Economic Theory and Judicial Process: A Case Study," _Antitrust Bulletin_, Vol. 20, No. 4, Winter 1975, pp. 775-802, especially pp. 782-802.

[69] Leonard Sloane, "Reciprocity, Where Does the P.A. Stand?" _Purchasing_, Vol. 51, November 20, 1961, pp. 70-79.

[70] _Ibid._, p. 71.

[71] _Ibid._, pp. 76-77. The subsequent discussion is taken from the table.

[72] _Ibid._, pp. 72-73.

[73] F.R. Finney, "Reciprocity and Public Policy," _Antitrust Law & Economics Review_, Vol. 2, No. 4, Summer 1969, p. 105 (emphasis in the original).

[74] Sloane, p. 72.

[75] _Ibid._, p. 73.

[76] _Ibid._, p. 76.

[77] _Ibid._

[78] Finney, "Reciprocal Buying and Public Policy," p. 101.

[79] Edward McCreary Jr. and Walter Guzzardi Jr., "A Customer Is a Company's Best Friend," _Fortune_, June 1965, p. 194.

[80] Corwin D. Edwards, "The Changing Dimensions of Business Power," _St. John's Law Review_, Vol. 44, Special Edition, Spring 1970, p. 436, Footnote 35.

[81] _Ibid._, p. 436, Footnote 35.

[82] McCreary and Guzzardi, p. 180.

[83] _Ibid._, p. 194.

[84] "Selling's Buddy System," _Sales Management_, Vol. 98, February 1, 1967, p. 27.

[85] Ibid., p. 28.

[86] Ibid., p. 28. In 1970, apparently as a result of the legal attacks on reciprocity, only 70 companies were members of the Trade Relations Association (Sales Management, "Reciprocity Is Dead," October 15, 1970, p. 27).

[87] J. Weingarten, "Reciprocity Under Fire," Dun's Review, Vol. 92, No. 3, September 1968, p. 36.

[88] Ibid.

[89] Ibid., p. 37.

[90] Jack R. Dauner, "The Attitude of the Purchasing Agent Toward Reciprocity," Journal of Purchasing, Vol. 3, August 1967, pp. 5-15.

[91] Ibid., p. 8.

[92] Ibid., p. 10, Table 4.

[93] Ibid., p. 6.

[94] Ibid., p. 9.

[95] Ibid., p. 10.

[96] Ibid.

[97] Ibid., p. 11.

[98] Ibid.

[99] Ibid., pp. 13-14.

[100] Ibid., p. 11.

[101] Ibid., p. 12.

[102] Ibid.

[103] *Ibid.*, p. 10, Table 4.

[104] *Ibid.*, p. 10.

[105] F.R. Finney, "Reciprocal Buying and Public Policy," p. 75.

[106] *Ibid.*, p. 25.

[107] *Ibid.*, pp. 55, 74-75.

[108] *Ibid.*, pp. 75-76.

[109] *Ibid.*, p. 76.

[110] Staff Report of the Federal Trade Commission, *Economic Report in Corporate Mergers* (Washington, D.C., U.S.G.P.O., 1969), pp. 328-332.

[111] *Ibid.*, pp. 332-336 and 338-340.

[112] *Ibid.*, p. 336.

[113] *Ibid.*

[114] *Ibid.*

[115] *Ibid.*, p. 337.

[116] *Ibid.*

[117] *Ibid.*, pp. 341-354, 354-372, 373-382 and 383-393, respectively.

[118] Paul W. MacAvoy, "The Federal Trade Commission: Staff Economic Report on Corporate Mergers," *ABA Antitrust Law Symposium*, 1970, p. 65.

[119] *Ibid.*, p. 66.

[120] *1971 Trade Cases*, Par. 73619, p. 90558 and p. 90558, n. 45. The information was collected under Rule 31 of the Federal Rules of Civil Procedure.

[121] Jesse W. Markham, Conglomerate Enterprise and Public Policy (Boston, Division of Research, Graduate School of Business Administration, Harvard University, 1973), p. 52.

[122] Ibid., pp. 52-53.

[123] Ibid., p. 76.

[124] Ibid.

[125] Ibid., p. 79.

[126] Ibid., p. 78.

[127] Ibid., pp. 79-80.

[128] Ibid., p. 80.

[129] Ibid., pp. 80-81.

[130] Ibid.

[131] Ibid., p. 81.

[132] See Peter Asch and Matityahu Marcus, "Some Economic Aspects of Conglomerate Growth," St. John's Law Review, Vol. 44, Special Edition, 1970, pp. 86-87 and Joel B. Dirlam, "Observations on Public Policy Toward Conglomerate Mergers," St. John's Law Review, Vol. 44, Special Edition, 1970, p. 203.

[133] Markham, p. 82.

[134] Ibid., p. 41.

[135] U.S. v. Airco Inc., Federal Supplement, Vol. 386, 1974, 915 at p. 919.

[136] The usual term of the decree ordered the defendant firm to "Refrain from being a member of and to prohibit its officers and employees from belonging to or participating in the activities of, or contributing anything of value to, any association whose activities, programs or objectives are to promote trade relations involving reciprocal purchasing arrangements." (U.S. v. Inland Steel Co., 1970 Trade Cases, Par. 73197, p. 88741.)

[137] Monroe C. Bird and C. Wayne Shepherd, "Reciprocity in Industrial Buying and Selling: A Study of Attitudes," Journal of Purchasing, Vol. 9, November 1973, p. 32.

[138] Ibid., pp. 33-34. The proportion undecided was 9.3% and 14.8% respectively.

[139] Ibid., pp. 33-34. The proportion undecided was 37.4% and 33.3% respectively.

[140] Ibid., pp. 33-34. The percentages in the undecided category for purchasing and sales managers for the last three questions respectively were 21.6, 19.8; 18.7, 14.8; 25.9, 17.3.

[141] Claudia H. Deutsch, "Reciprocal Trade: It's Still an Issue," Purchasing, Vol. 75, November 6, 1973, p. 37.

[142] Ibid.

[143] Ibid.

[144] Finney, "Reciprocal Buying and Public Policy," p. 55.

[145] Deutsch, p. 39.

[146] Ibid., p. 37.

[147] Ibid., p. 39.

[148] Testimony of Dr. John Narver, Royal Commission on Corporate Concentration, Vancouver, B.C., November 14, 1975, p. 597. On the basis of the FTC's announcement that it would no longer accept Assurances of Voluntary Compliance from corporations engaging in reciprocal dealing, Sales Management published an article on October 15, 1970 (pp. 27-28) with the title "Reciprocity is Dead," but the subtitle was, "Now if only the corpse will stop kicking we'll proceed with the burial." Apparently the same point could be made in 1976.

NOTES

CHAPTER 5

## ECONOMIC AND MANAGERIAL ASPECTS OF RECIPROCAL BUYING

[1] George W. Stocking and Willard F. Mueller, "Business Reciprocity and the Size of Firms," Journal of Business, Vol. 30, No. 2, April 1957, p. 75.

[2] Roger D. Blair, "Reciprocity and Competition: A Problem of Conflicting 'Assumptions,'" Antitrust Law and Economics Review, Vol. 6, No. 3, 1973, p. 78.

[3] Lee E. Preston, "A Probabilistic Approach to Conglomerate Mergers," St. John's Law Review, Vol. 44, Special Edition, 1970, pp. 341-355.

[4] Ibid., p. 353.

[5] Ibid., p. 354

[6] Mary Gardiner Jones and Edward J. Heiden, "Conglomerates: The Need for Rational Policy Making," St. John's Law Review, Vol. 44, Special Edition, 1970, p. 251.

[7] Stocking and Mueller, p. 77.

[8] Bruce T. Allen, "Industrial Reciprocity: A Statistical Analysis," Journal of Law and Economics, Vol. 18, No. 2, October 1975, p. 508.

[9] Joel B. Dirlam, "Observations on Public Policy Toward Conglomerate Mergers," St. John's Law Review, Vol. 44, Special Edition, 1970, p. 203.

[10] Oliver E. Williamson, Markets and Hierarchies: Analysis and Antitrust Implications (New York, The Free Press, 1975), p. 164.

[11] Jesse W. Markham, Conglomerate Enterprise and Public Policy (Division of Research, Graduate School of Business Administration, Harvard University, Boston, 1973), p. 80.

[12]Allen, p. 519.

[13]Ibid.

[14]Ibid.

[15]Supreme Court Reporter, Vol. 85, 1965, 1220 at p. 1227.

[16]Stocking and Mueller, p. 75.

[17]Federal Supplement, Vol. 258, 1966, 36 at p. 40.

[18]1971 Trade Cases, Par. 73424, p. 89767.

[19]1971 Trade Cases, Par. 73619, pp. 90540-90541.

[20]Federal Supplement, Vol. 258, 1966, 36 at p. 42.

[21]1963 Trade Cases, Par. 70802, pp. 78211-78223.

[22]1969 Trade Cases, Par. 72943, p. 87650.

[23]Willard F. Mueller, "The Rising Economic Concentration in America: Reciprocity, Conglomeration, and the New American 'Zaibatsu' System II," Antitrust Law and Economics Review, Vol. 4, No. 4, 1971, p. 94.

[24]1969 Trade Cases, Par. 72943, p. 87650.

[25]1971 Trade Cases, Par. 73619, p. 90549.

[26]Ibid., p. 90550.

[27]1969 Trade Cases, Par. 72690, pp. 86454-86459, and 1969 Trade Cases, Par. 72856, pp. 87178-87212.

[28]1971 Trade Cases, Par. 73487, pp. 89991-89995.

[29]1969 Trade Cases, Par. 72853, pp. 87150-87177.

[30]Stocking and Mueller, p. 76.

[31] Federal Supplement, Vol. 258, 1966, 36 at p. 40.

[32] Ibid., p. 42.

[33] "Reciprocity: Dangerous Selling Tool Winning New Users," Sales Management, May 20, 1960, p. 40.

[34] Ibid.

[35] Leonard Sloane, "Reciprocity: Where Does the P.A. Stand?" Purchasing, Vol. 51, November 20, 1961, pp. 70-79,

[36] Jack R. Dauner, "The Attitude of the Purchasing Agent Toward Reciprocity," Journal of Purchasing, Vol. 3, August 1967, p. 10.

[37] Monroe M. Bird, "Time Reciprocity: A Possible Answer to Shortages," Journal of Purchasing and Materials Management, Vol. 10, November 1974, p. 48.

[38] Ibid., p. 49.

[39] James H. Lorie and Paul Halpern, "Conglomerates: The Rhetoric and the Evidence," Journal of Law and Economics, Vol. 13, April 1970, p. 151.

[40] James M. Ferguson, "Tying Arrangements and Reciprocity: An Economic Analysis," Law and Contemporary Problems, Vol. 30, No. 3, Summer 1965, pp. 552-580, as reprinted in W. Sichel (ed.), Industrial Organization and Public Policy: Selected Readings (Boston, Houghton Mifflin Co., 1967), p. 314.

[41] Stocking and Mueller, p. 76.

[42] Ibid.

[43] A most useful discussion of monopsony is given in Joe S. Bain, Price Theory (New York, John Wiley & Sons, 1966), Ch. 9, pp. 377-399.

[44] Ferguson, p. 305.

[45] If B is a true monopsonist, but Industry III is perfectly competitive, B's market power takes the form of buying

less and at a lower price (if Industry III's has an upward-sloping supply curve) than would be the case if B had no monopsony power. However, while individual producers will receive less revenue under monopsony they still earn normal returns in the long run.

[46] Stocking and Mueller, p. 76.

[47] Donald F. Turner, "Conglomerate Mergers and Section 7 of the Clayton Act," Harvard Law Review, Vol. 78, No. 7, May 1965, pp. 1387-1388.

[48] Turner (p. 1389) concludes that "while we cannot be certain that reciprocity foreclosure will take place under the conditions set forth above [(i)...(iv)], the conditions indicate not only circumstances in which substantial foreclosure is possible, but also circumstances in which some foreclosure is highly probable."

[49] Frederic M. Scherer, Industrial Market Structure and Economic Performance (Chicago, Rand McNally & Co., 1970), p. 282.

[50] Mueller, p. 93, emphasis in the original.

[51] Finney defines leverage as the "power to influence a supplier, either overtly or otherwise, merely by being such an important customer of that supplier as to make him eager to do anything reasonable to maintain his position. [Leverage] usually means a company which purchases large dollar amounts of one or more inputs from an imperfectly competitive group or groups of suppliers while selling less to the suppliers in return." See Frank Robert Finney, "Reciprocal Buying and Public Policy" (unpublished Ph.D. dissertation, University of California, Berkeley, Faculty of Business Administration, 1968), p. 109.

[52] Federal Trade Commission Decisions, Vol. 15, 1931, 232 at pp. 236-237, 239.

[53] Federal Supplement, Vol. 258, 1966, 36 at p. 61.

[54] 1969 Trade Cases, Par. 72856, p. 87196.

[55] 1971 Trade Cases, Par. 73619, pp. 90545-90546.

[56] Stocking and Mueller, p. 94.

[57] Staff Report of the Federal Trade Commission, Economic Report on Corporate Mergers (Washington, D.C., 1969), pp. 329, 330.

[58] Ibid., p. 330, emphasis in the original.

[59] In the section on foreclosure or barriers to entry (p. 86) we discuss circumstances under which an oligopolist would initiate reciprocal dealing. Unless the initiating firm has a division or affiliated firm which supplies its potential reciprocity partner(s) that is unique in the industry, the oligopolist's competitors can also offer reciprocity. Therefore, they can retaliate in kind and reciprocity may serve to undermine the oligopolistic price structure.

[60] Wesley J. Leibeler, "The Emperor's New Clothes: Why Is Reciprocity Anticompetitive?" St. John's Law Review, Vol. 44, Special Edition, 1970, pp. 552-553.

[61] J.P. Anderson, "Reciprocal Dealing," Yale Law Journal, Vol. 76, 1967, p. 1024.

[62] Dirlam, p. 202.

[63] Anderson, p. 1025. From the first part of the sentence it is obvious that he has missed Ferguson's point about convenience reciprocity between firms in competitive markets.

[64] Aaron Director and Edward H. Levi, "Law and the Future: Trade Regulation," Northwestern University Law Review, Vol. 51, 1956, p. 290.

[65] Report of the Task Force on Productivity and Competition as reprinted in Antitrust Law and Economics Review, Vol. 2, No. 3, Spring 1969, p. 31.

[66] Joel Dean, "Economic Aspects of Reciprocity," Antitrust Bulletin, Vol. 8, Sept.-Oct., 1963, p. 846.

[67] Blair, p. 79.

[68] Peter O. Steiner, Mergers: Motives, Effects, Policies (Ann Arbor, University of Michigan Press, 1975), p. 229, n. 17.

[69] *Ibid*.

[70] *1971 Trade Cases*, Par. 73619, p. 90551.

[71] *Ibid*., p. 90552.

[72] Steiner, p. 229.

[73] See John D. Garrison and Arthur B. Hooker, "Trade Relations: Some Misconceptions and Realities," *Business Lawyer*, Vol. 22, July 1967, pp. 1137-1150.

[74] *Federal Supplement*, Vol. 258, 1966, 36 at p. 45.

[75] Ferguson, p. 302.

[76] *Federal Trade Commission Decisions*, Vol. 15, 1931, pp. 232-248.

[77] *Federal Trade Commission Decisions*, Vol. 16, 1932, pp. 67-76.

[78] Richard A. Miller, "Conglomerate Mergers: A Monopoly Problem?" *St. John's Law Review*, Vol. 44, Special Edition, 1970, p. 232.

[79] Anderson, p. 1026.

[80] *Ibid*., p. 1027.

[81] Unless the regulatory authority has the ability to subsidize where average (and marginal) costs fall over the relevant range of output, it will have to set the tariffs at a level above marginal cost to ensure that total costs are recovered.

[82] This discussion must of necessity ignore the problem of second best. See R.C. Lipsey and R.K. Lancaster, "The General Theory of Second Best," *Review of Economic Studies*, Vol. 24, 1956-1957, pp. 11-32.

[83] Ferguson, p. 306.

[84] Ferguson, p. 306. Obviously, there is no physical coercion, but what the large buyers are doing is offering their shipping business (at the ICC-specified tariffs) in return for the purchase of equipment from their affiliate, on an all or nothing basis. They are saying, "either you buy from my equipment firm or lose all my business." So long as the railroads net position is just better under the reciprocal dealing arrangement than it would be if it lost the large chunk of business offered by the shippers, it will have to go along with the deal as the lesser of evils.

[85] Ibid.

[86] Ibid.

[87] Miller, p. 233.

[88] L.W. Keeshan, "Conglomerate Mergers and the Theory of Reciprocity," Stanford Law Review, Vol. 22, 1970, p. 826.

[89] Harlan M. Blake, "Conglomerate Mergers and the Antitrust Laws," Columbia Law Review, Vol. 73, March 1973, p. 87.

[90] Mueller, pp. 95-96.

[91] Keeshan, p. 822, n. 46.

[92] Richard Caves, Testimony before the Royal Commission on Corporate Concentration, Ottawa, November 4, 1975, p. 251 (transcript).

[93] Ibid., p. 252.

[94] Ibid.

[95] Leibeler, p. 548.

[96] Ibid., p. 549.

[97] Ibid., p. 550.

[98] Ibid., p. 557.

[99] See Steiner, pp. 232-233.

[100]*United States Reports*, Vol. 334, 1948, 100 at p. 108.

[101]Anderson, p. 1027.

[102]*Ibid*.

[103]*Federal Trade Commission Decisions*, Vol. 15, 1931, 232 at p. 242.

[104]From the point of view of allocative efficiency, it is preferable that the affiliate buy and resell at higher price than produce an inferior product.

[105]*Federal Supplement*, Vol. 258, 1966, 36 at pp. 40, 42.

[106]*Ibid*., p. 41.

[107]*Ibid*., p. 39.

[108]*1969 Trade Cases*, Par. 72943, p. 87646.

[109]*1971 Trade Cases*, Par. 73424, p. 89767.

[110]See Manly R. Irwin, *The Telecommunications Industry: Integration versus Competition* (New York, Praeger, 1971).

[111]Erwin A. Blackstone, "Monopsony Power, Reciprocal Buying, and Government Contracts: The General Dynamics Case," *Antitrust Bulletin*, Vol. 17, Summer 1972, p. 445.

[112]*Ibid*., p. 449.

[113]*Ibid*.

[114]*Ibid*., p. 457.

[115]*Ibid*., pp. 464-465.

[116]Steiner, p. 234.

[117]*Ibid*., p. 235.

[118]*Ibid*.

[119]*Ibid.*, p. 236

[120]*Ibid.*

[121]Allen, p. 509.

[122]*Supreme Court Reporter*, Vol. 85, 1965, 1220 at p. 1224.

[123]Mueller, p. 121.

[124]*Ibid.*, p. 95.

[125]*Ibid.*, p. 96.

[126]*Ibid.*, pp. 96-97.

[127]Mueller, p. 97.

[128]Ferguson, p. 305.

[129]Finney, p. 127.

[130]Denenberg and Cummins, p. 376.

[131]*Ibid.*, n. 19.

[132]*Ibid.*

[133]*Ibid.*, p. 377.

[134]Mueller, p. 93.

[135]Finney, p. 131.

[136]*Ibid.*, p. 134.

[137]*Ibid.*, p. 111, emphasis on the original.

[138]*Ibid.*, p. 113.

[139] Ibid., p. 114.

[140] Waugh Equipment, Federal Trade Commission Decisions, Vol. 15, 1931, pp. 232-248, Mechanical Manufacturing, Federal Trade Commission Decisions, Vol. 16, 1932, pp. 67-76.

[141] Leonard S. Simon, "Industrial Reciprocity as a Business Stratagem," Industrial Management Review, Vol. 7, No. 2, Spring 1966, p. 30.

[142] Ibid., p. 32.

[143] See also Allen, p. 509.

[144] Simon, p. 38.

[145] Ibid., pp. 38-39.

[146] Keeshan, pp. 820-821.

[147] Ferguson, p. 304.

[148] Ibid., p. 303.

[149] Malcolm C. Neuhoff and G. Clark Thompson, "Reciprocity -- Many Practice, Few Favor," Conference Board Business Record, March 1954, pp. 108-109.

[150] Ibid., p. 109.

[151] "Reciprocity: Dangerous Selling Tool Winning New Users" Sales Management, May 20, 1960, p. 42.

[152] Ibid.

[153] Dean S. Ammer, "Realistic Reciprocity," Harvard Business Review, Vol. 40, Jan.-Feb., 1962, p. 122.

[154] Ibid.

[155] Ibid.

[156] _Ibid._

[157] L.E. Birdzell, "The Conglomerates: A Neighbor's View," _St. John's Law Review_, Vol. 44, Special Edition, 1970, p. 31.

[158] Harold S. Geneen, "Conglomerates: A Businessman's View," _St. John's Law Review_, Vol. 44, Special Edition, 1970, p. 729.

[159] _Ibid._

[160] _Ibid._, p. 731.

[161] _Ibid._, p. 730.

[162] Robert E. Weigand, "The Problems of Managing Reciprocity," _California Management Review_, Vol. 16 (Fall 1973), p. 44.

[163] _Ibid._, p. 45.

[164] _Ibid._, p. 46.

[165] _Ibid._, p. 47.

[166] Ammer, p. 120.

[167] Ferguson, pp. 303-304.

[168] Keeshan, p. 821.

[169] Stocking and Mueller, p. 93.

[170] Keeshan, p. 820.

[171] Stocking and Mueller, p. 87, n. 64.

[172] A.W. Gouldner, "The Norm of Reciprocity," _American Sociological Review_, Vol. 25, 1961, pp. 161-179.

[173]Cited in Robert M. Hausman, "Reciprocal Dealing and the Antitrust Laws," Harvard Law Review, Vol. 77, March 1964, p. 875.

[174]Finney, pp. 84-85.

[175]ITT-Canteen, 1971 Trade Cases, Par. 73619, pp. 90530-90561; ITT-Grinnell, 1969 Trade Cases, Par. 72943, pp. 87633-87660 and 1971 Trade Cases, Par. 73424, pp. 89744-89776; ITT-Hartford, 1969 Trade Cases, Par. 72943, pp. 87633-87660 (the Grinnell and Hartford decisions on the preliminary injunction are contained in the same judgment).

[176]1971 Trade Cases, Par. 73487, pp. 89991-89995.

[177]Federal Supplement, Vol. 242, 1975, pp. 518-526.

[178]A list of these consent decrees is given in Appendix B.

[179]Williamson, p. 119.

[180]1971 Trade Cases, Par. 73487, pp. 89993-89994.

[181]1971 Trade Cases, Par. 73619, p. 90552.

[182]1969 Trade Cases, Par. 72943, p. 87652.

[183]Harold S. Geneen, "Concept of a Conglomerate or a Multi-Market Company: A Businessman's View," ABA Antitrust Law Journal, Vol. 39, 1969, p. 7.

[184] Ibid.

[185] Ibid., p. 13.

[186]Anthony Sampson, The Sovereign State of ITT (Greenwich, Conn., Fawcett Publications, 1974), p. 126.

[187]1971 Trade Cases, Par. 73619, p. 90552.

[188]U.S. v. Airco Inc., Federal Supplement, Vol. 386, 1974, 915 at pp. 919-920.

[189] 1969 Trade Cases, Par. 72853, p. 7171.

[190] ITT-Grinnell, 1971 Trade Cases, Par. 73424, p. 89769.

[191] 1971 Trade Cases, Par. 73619, p. 90551.

[192] D.F. Zoll, "The Making and Selling of an Antireciprocity Program," ABA Law Notes, Vol. 9, Fall 1972, p. 2.

[193] Ibid., p. 3.

[194] 1971 Trade Cases, Par. 73619, p. 90552.

## NOTES

## CHAPTER 6

## RECIPROCAL BUYING AND THE LAW

[1]Exerpts from the relevant statutes can be found in Appendix A.

[2]Waugh Equipment et al., Federal Trade Commission Decisions, Vol. 15, 1931, pp. 232-248.

[3]Mechanical Manufacturing et al., Federal Trade Commission Decisions, Vol. 16, 1932, pp. 67-76.

[4]California Packing Corporation et al., Federal Trade Commission Decisions, Vol. 25, 1937, pp. 379-401.

[5]There are three cases involving Consolidated Foods: the initial Federal Trade Commission decision, Consolidated Foods Corporation, Federal Trade Commission Decisions, Vol. 62, 1963, pp. 929-968; the appeal court decision, Consolidated Foods Corporation v. Federal Trade Commission, Federal Reporter, 2d Series, Vol. 329, 1964, pp. 623-627; and the Supreme Court decision, Federal Trade Commission v. Consolidated Foods Corporation, Supreme Court Reporter, Vol. 85, 1965, pp. 1220-1229.

[6]U.S. v. International Telephone and Telegraph Corporation (Canteen), 1971 Trade Cases, Par. 73619, pp. 90530-90561.

[7]The decision on the preliminary injunction is U.S. v. International Telephone and Telegraph Corporation and Grinnell Corporation, 1969 Trade Cases, Par. 72943, pp. 87633-87660. The decision on the trial on the merits is U.S. v. International Telephone and Telegraph Corp. (Grinnell), 1971 Trade Cases, Par. 73424, pp. 89744-89776.

[8]U.S. v. International Telephone and Telegraph Corporation and the Hartford Fire Insurance Company, 1969 Trade Cases, Par. 72943, pp. 87633-87660.

[9]U.S. v. General Dynamics, Federal Supplement, Vol. 258, 1966, pp. 36-67.

[10]U.S. v. Northwest Industries, Inc., and The B.F. Goodrich Co., _1969 Trade Cases_, Par. 72853, pp. 87150-87177.

[11]U.S. v. Penick & Ford, Ltd., and R.J. Reynolds, _Federal Supplement_, Vol. 242, 1965, pp. 518-526.

[12]The decision on the preliminary injunction is U.S. v. Ingersoll-Rand Company et al., _Federal Supplement_, Vol. 218, 1963, pp. 530-556. The appeal court decision on the injunction is U.S. v. Ingersoll-Rand Company et al., _1963 Trade Cases_, Par. 70802, pp. 78211-78223.

[13]U.S. v. White Consolidated Industries and White Motor Corp., _1971 Trade Cases_, Par. 73487, pp. 89991-89995.

[14]The decision on the preliminary injunction is Allis-Chalmers Manufacturing Co. v. White Consolidated Industries, Inc., _1969 Trade Cases_, Par. 72690, pp. 86454-86459. The appeal court decision is Allis-Chalmers Mfg. Co. v. White Consolidated Industries, Inc., _1969 Trade Cases_, Par. 72856, pp. 87187-87212.

[15]Stavrides et al. v. Mellon National Bank and Trust Co. et al., _1973 Trade Cases_, Par. 74327, pp. 93504-93408.

[16]U.S. v. Airco, Inc., _Federal Supplement_, Vol. 386, 1974, pp. 915-926.

[17]W.L. Gore & Associates, Inc. v. Carlisle Corp., _1974-2 Trade Cases_, Par. 75420, pp. 98384-98393.

[18]Carlson Companies Inc. et al. v. The Sperry and Hutchinson Co., _1974-2 Trade Cases_, Par. 75153, pp. 97172-97174.

[19]Columbia Nitrogen Corporation v. Royster Company, _Federal Reporter_, 2d Series, Vol. 451, 1971, pp. 3-16.

[20]Farris notes that of the 20 consent decrees filed between August 25, 1969 and November 1, 1972, three involved secondary reciprocity (LTV-Jones & Laughlin, General Tire et al. and Jackson Atlantic Ready Mix). See Martin T. Farris, "Purchasing Reciprocity and Antitrust," _Journal of Purchasing_, Vol. 9, February 1973, pp. 5-14.

[21]Farris, p. 11.

[22] *Ibid.*, pp. 11-14.

[23] "The Antitrust Specialist and Dragon Slayer," *Business Week*, May 12, 1973, p. 120 and "Trustbusting: A New Role for Companies," *Business Week*, August 12, 1972, pp. 51-53.

[24] F. Marion Hughes, "Reciprocity and Economic Concentration Aspects of the ITT Mergers--Should the Government Have Settled?" *South Carolina Law Review*, Vol. 25, 1973, p. 683.

[25] *Ibid.*, p. 684.

[26] Stanley E. Boyle, "U.S. v. ITT--Incompetence, Irrelevance and Confusion," *Antitrust Bulletin*, Vol. 19, Summer 1974, p. 327. For more on the Justice Department's settlement of the ITT cases see Anthony Sampson, *The Sovereign State of ITT* (Greenwich, Conn., Fawcett Publications, 1974),Ch. 7,8.

[27] *Supreme Court Reporter*, Vol. 85, 1965, 1220 at p. 1222.

[28] This case is discussed in some detail in Ferguson, Leibeler, Hinnegan, Donnelley, Note (*Virginia Law Review*), Harvith, Harsha, Austin, Jones, and Brodley. See the Bibliography for full citations.

[29] *Federal Trade Commission Decisions*, Vol. 62, 1963, 929 at p. 930.

[30] *Ibid.*, pp. 938-943.

[31] *Ibid.*, p. 944.

[32] *Ibid.*, pp. 959-960.

[33] *Ibid.*, p. 960, n. 10.

[34] *Ibid.*, p. 949.

[35] *Ibid.*, pp. 949-950.

[36] *Ibid.*, p. 952.

[37] *Ibid.*, p. 953.

[38] *Ibid.*, p. 955.

[39] *Ibid.*

[40] *Ibid.*

[41] *Ibid.*, p. 948.

[42] *Ibid.*, p. 952.

[43] *Ibid.*, p. 957.

[44] *Ibid.*, p. 959.

[45] *Ibid.*, p. 958.

[46] *Ibid.*

[47] *Federal Reporter*, 2d Series, Vol. 329, 1964, 623 at p. 627.

[48] *Ibid.*, p. 626. Only the latter phrase is the Court's.

[49] *Ibid.*, p. 626.

[50] *Ibid.*

[51] *Ibid.*

[52] *Ibid.*, p. 627.

[53] *Supreme Court Reporter*, Vol. 85, 1965, 1220 at p. 1226.

[54] *Ibid.*, pp. 1221-1222.

[55] *Ibid.*, p. 1222.

[56] *Ibid.*

[57] *Ibid.*

[58] *Ibid.*, p. 1224.

[59] *Ibid.*

[60] *Ibid.*, p. 1225.

[61] *Ibid.*

[62] *Ibid.*

[63] *Ibid.*

[64] *Ibid.*, p. 1226.

[65] *Ibid.*

[66] *Ibid.*

[67] *Ibid.*, p. 1227.

[68] *Ibid.*

[69] See William G. Shepherd, *Market Power and Economic Welfare* (New York, Random House, 1970), Ch. 3, 7, 8. Willard F. Mueller argues that the *conglomerate* character of firms ought to be recognized as a separate characteristic of market structure. See his "The Rising Economic Concentration in America: Reciprocity, Conglomeration, and the New American 'Zaibatsu' System II," *Antitrust Law and Economics Review*, Vol. 4, No. 4, 1971, p. 102.

[70] *Supreme Court Reporter*, Vol. 85, 1965, 1220 at p. 1227.

[71] *Ibid.*,

[72] *Ibid.*, pp. 1227-1228.

[73] *Federal Reporter*, 2d Series, Vol. 329, 1964, 623 at p. 625.

[74] *Ibid.*, p. 625.

[75] *Ibid.*,

[76]Supreme Court Reporter, Vol. 85, 1965, 1220 at p. 1228.

[77]Ibid.

[78]Ibid.

[79]Ibid.

[80]Ibid.

[81]Ibid.

[82]Ibid., p. 1229.

[83]Ibid.

[84]Ibid.

[85]Federal Trade Commission Decisions, Vol. 62, 1963, 929 at p. 957.

[86]CCH, Trade Regulation Reports, 1971, Par. 4510.

[87]Donald F. Turner, Conglomerate Mergers and Section 7 of the Clayton Act," Harvard Law Review, Vol. 78, No. 7, May 1965, p. 1391.

[88]Ibid., p. 1393.

[89]K.A. Hinnegan, "Potential Reciprocity and the Conglomerate Merger: Consolidated Foods Revisited," Buffalo Law Review, Vol. 17, 1968, pp. 646, 647.

[90]Ibid., p. 646.

[91]Ibid.

[92]Ibid.

[93]Ibid.

[94] Discussions of this case can be found in Bernard E. Harvith, "Reciprocity and the Federal Antitrust Laws," Washington Law Review, Vol. 40, 1965, pp. 133-188, specifically pp. 177-183.

[95] Federal Supplement, Vol. 218, 1963, 530 at p. 536.

[96] Ibid., p. 552.

[97] Ibid., p. 551.

[98] Ibid.

[99] Ibid., p. 552.

[100] Ibid.

[101] Ibid.

[102] Ibid.

[103] Federal Trade Commission Decisions, Vol. 62, 1963, 929 at p. 952.

[104] 1963 Trade Cases, Par. 70802, pp. 78220-78221.

[105] Ibid., p. 78220.

[106] Ibid., p. 78223.

[107] In 1961 the value of shipments of SIC #3312 Blast Furnace and Steel Mill Products was $14,873 million. (Department of Commerce, Metal and Fabricated Metal Produces Manufacturing, Washington, D.C., USGPO, April 1969, Table II-4.)

[108] The District Court judge stated, "This industry is composed of ten firms engaged in the production from raw corn and sorghum grain of starch, dextrin, corn syrup and other by-products by a process known as wet milling." Federal Supplement, Vol. 242, 1965, 518 at p. 520.

[109] Federal Supplement, Vol. 242, 1965, 518 at p. 526.

[110] *Ibid.*

[111] *Ibid.*, p. 521.

[112] *Ibid.*

[113] *Ibid.*, p. 523.

[114] *Ibid.*, p. 524.

[115] *Ibid.*

[116] *Ibid.*

[117] *Ibid.*, p. 522.

[118] *Ibid.*, p. 525.

[119] *Ibid.*

[120] *Ibid.*, p. 522.

[121] *Ibid.*, p. 523.

[122] *Ibid.*

[123] *Ibid.*, p. 524.

[124] *Ibid.*, pp. 524-525.

[125] *Ibid.*, p. 526.

[126] *1969 Trade Cases*, Par. 72886.

[127] This case is discussed in the articles by Garrison and Hooker, Borteck, Flinn, Note (*New York Law Forum*), Note (*New York University Law Review*). See the Bibliography for detailed citations.

[128] *Federal Supplement*, Vol. 258, 1966, 36 at p. 37.

[129] *Ibid.*, p. 42.

[130] *Ibid.*, p. 62.

[131] *Ibid.*, p. 45.

[132] *Ibid.*

[133] *Ibid.*, p. 47.

[134] *Ibid.*, p. 49.

[135] *Ibid.*, p. 50.

[136] *Ibid.*, pp. 50-51.

[137] *Ibid.*, p. 56.

[138] *Ibid.*, p. 57.

[139] *Ibid.*, p. 59.

[140] *Ibid.*

[141] *Ibid.*

[142] *Ibid.*, p. 60.

[143] *Ibid.*, p. 61.

[144] *Ibid.*, p. 61. Willard F. Mueller writes, "when a firm reaches a size and level of diversification that creates substantial reciprocity opportunities, the profit incentive to seize those opportunities becomes irresistible....to permit [reciprocity] to exist is to encourage its use." (Mueller, p. 97.)

[145] *Federal Supplement*, Vol. 258, 1966, 36 at p. 62.

[146] *Ibid.*, p. 63.

[147] *Ibid.*

[148] *Ibid*.

[149] *Ibid*., p. 64.

[150] *Ibid*.

[151] *Ibid*.

[152] *Ibid*., p. 64, n. 176.

[153] This case is discussed in the articles by Keeshan, Borteck, Roehl, Note (*Georgetown Law Journal*). See the Bibliography for detailed citations.

[154] *1969 Trade Cases*, Par. 72690, pp. 86458-86459.

[155] *Ibid*., p. 86458.

[156] *1969 Trade Cases*, Par. 72856, p. 87194.

[157] *Ibid*., p. 87201.

[158] Ibid., p. 87202.

[159] *Ibid*., p. 87190.

[160] *Ibid*., p. 87203 (Judge Aldisert).

[161] *Ibid*., p. 161.

[162] *Ibid*., p. 87196.

[163] *Ibid*.

[164] *Ibid*., p. 87197.

[165] *Ibid*.

[166] *Ibid*., p. 87201.

[167] *Ibid*., p. 87203.

[168] *Ibid.*, p. 87207.

[169] *Ibid.*

[170] *Ibid.*, p. 87208.

[171] *Ibid.*

[172] *1969 Trade Cases*, Par. 72853, p. 87175.

[173] *Ibid.*

[174] *Ibid.*, p. 87174.

[175] *Ibid.*, p. 87168.

[176] *Ibid.*, p. 87167.

[177] *Ibid.*, p. 87168.

[178] *Ibid.*, p. 87169.

[179] *Ibid.*, p. 87170.

[180] *Ibid.*, p. 87171.

[181] *Ibid.*

[182] *Ibid.*, p. 87174.

[183] *Ibid.*

[184] See Tom O'Hanlon, "Goodrich's Four-Ply Defense," *Fortune*, July 1969, pp. 110-113, 182-184, 189, and "Northwest Calls it Quits on Goodrich," *Business Week*, August 16, 1969, p. 41.

[185] See Sampson, Ch. 7.

[186] The three consent decrees are reported in *1971 Trade Cases*, Par. 73665, 73666 and 73667.

[187] Boyle, p. 329.

[188] Hughes, p. 682.

[189] _Ibid._, p. 683.

[190] This case, and the trial on the merits, is discussed in Keeshan, Blake, Dunne, and Borteck. See the Bibliography for detailed citations.

[191] _1969 Trade Cases_, Par. 72943, pp. 87640, 87642.

[192] _Ibid._, p. 87640.

[193] _Ibid._, p. 87646.

[194] _Ibid._

[195] _Ibid._

[196] _Ibid._, p. 87647.

[197] _Ibid._, pp. 87646-87647.

[198] _Ibid._, p. 87647.

[199] _Ibid._, p. 87648.

[200] _Ibid._

[201] _Ibid._, p. 87649.

[202] _1971 Trade Cases_, Par. 73424, p. 89752.

[203] _Ibid._, p. 89756. Professor Stanley Boyle provides evidence that appears to refute the judge's conclusion (Boyle, pp. 340-344).

[204] _Ibid._, p. 89766.

[205] _Ibid._, p. 89767.

[206] _Ibid._

[207] *Ibid.*, emphasis in the original.

[208] *Ibid.*, p. 89768.

[209] *Ibid.*

[210] Hughes, p. 665.

[211] Boyle, p. 359, provides a diagramatic representation of the relationships.

[212] *1971 Trade Cases*, Par. 73424, pp. 89767-89768.

[213] Staff Report of the Federal Trade Commission, *Economic Report on Corporate Mergers* (Washington, D.C., 1969), pp. 357-359, 370.

[214] *1971 Trade Cases*, Par. 73424, p. 89768.

[215] *Ibid.*

[216] *Ibid.*, p. 89769.

[217] *1969 Trade Cases*, Par. 72943, p. 87649.

[218] *Ibid.*, p. 87563.

[219] *Ibid.*, p. 87650.

[220] *Ibid.*, pp. 87650-87651

[221] *Ibid.*, p. 87651.

[222] Herbert J. Denenberg and J. David Cummins, "Insurance and Reciprocity," *Journal of Risk and Insurance*, Vol. 38, No. 3, September, 1971, p. 370. Hughes makes similar points (Hughes, pp. 666-668).

[223] Denenberg and Cummins, p. 370.

[224] *Ibid.*, pp. 371-373.

[225] *1969 Trade Cases*, Par. 72943, p. 87651.

[226]Denenberg and Cummins, p. 376.

[227]*Ibid*.

[228]A critique of Denenberg and Cummins is given in Craig R. MacPhee, "Insurance and Reciprocity: Comment," *Journal of Risk and Insurance*, Vol. 40, No. 1, March 1973, pp. 139-141. Denenberg and Cummin's "Reply" is in the same volume, pp. 141-142.

[229]Denenberg and Cummins, p. 378.

[230]*Ibid*.

[231]*Ibid*., pp. 378-379.

[232]*Ibid*., p. 379.

[233]*Ibid*.

[234]*1971 Trade Cases*, Par. 73619, p. 90545.

[235]*Ibid*., pp. 90545-90546.

[236]*Ibid*., p. 90548.

[237]*Ibid*., pp. 90548-90549.

[238]*Ibid*., p. 90549.

[239]*Ibid*.

[240]*Ibid*.

[241]James M. Ferguson, "Tying Arrangements and Reciprocity: An Economic Analysis," *Law and Contemporary Problems*, Vol. 30, No. 3, Summer 1965, pp. 552-580, as reprinted in W. Sichel (ed.), *Industrial Organization and Public Policy: Selected Readings* (Boston, Houghton Mifflin Co., 1967),pp. 303-306.

[242]*1971 Trade and Cases*, Par. 73619, p. 90540.

[243] *Ibid.*, pp. 90541-90545.

[244] *Ibid.*, pp. 90549-90550.

[245] *Ibid.*, p. 90550.

[246] *Ibid.*, p. 90546.

[247] *Ibid.*, pp. 90546-90547.

[248] *Ibid.*, p. 90547.

[249] *Ibid.*

[250] *Ibid.*

[251] *Ibid.*, p. 90551.

[252] *Ibid.*

[253] *Ibid.*

[254] *Ibid.*, p. 90552.

[255] *Ibid.*

[256] *Ibid.*

[257] Hughes, pp. 674-675.

[258] Denenberg and Cummins, p. 379.

[259] *Ibid.*

[260] Oliver E. Williamson, *Markets and Hierarchies: Analysis and Antitrust Implications* (New York, The Free Press, 1975), p. 164.

[261] *Ibid.*, pp. 119-120.

[262]1971 Trade Cases, Par. 73619, p. 90552.

[263]Ibid., p. 90553.

[264]Ibid.

[265]Ibid., p. 90554.

[266]Ibid., p. 90555.

[267]Ibid.

[268]Ibid., p. 90556.

[269]Ibid., p. 90557.

[270]Ibid.

[271]Ibid.

[272]Ibid., p. 90558.

[273]1971 Trade Cases, Par. 73487, pp. 89991-89995.

[274]Ibid., p. 89994.

[275]Ibid.

[276]Ibid., p. 89993.

[277]Ibid.

[278]Ibid.

[279]Ibid.

[280]Ibid.

[281]Ibid., p. 89992.

[282]Ibid., p. 89993.

[283] *Ibid.*, p. 89994.

[284] The application of Sections 1 and 2 of the Sherman Act to reciprocal dealing is discussed in Donald Ferguson, "Business Reciprocity as a Sherman Act Violation: A Generally Accepted, But as Yet Unadjudicated, Doctrine," *West Virginia Law Review*, Vol. 74, 1972, pp. 343-366; Walker B. Comegys Jr. (Symposium Chairman), "United States v. General Tire and Rubber Company: Intracorporate Conspiracy and Sherman Act Reciprocity," *ABA Antitrust Law Journal*, Vol. 36, 1967, pp. 102-141, and in the articles by Hinnegan, Harvith, Barton, Dunne, Goldstein, Austin, Flinn, Smith, Note (*Valparaiso Law Review*), and Speh. See the Bibliography for detailed citations.

[285] See Footnote 127.

[286] *Federal Supplement*, Vol. 258, 1966, 36 at p. 55.

[287] *Ibid.*, pp. 51-52.

[288] *Ibid.*, p. 52.

[289] *Ibid.*, p. 53.

[290] *Ibid.*, p. 54.

[291] *Ibid.*, p. 66.

[292] *Ibid.*, p. 67.

[293] *Ibid.*, p. 56.

[294] *Ibid.*, p. 66.

[295] *Ibid.*

[296] See Hal M. Smith and Thomas M. Wilson III, "Reciprocity and the Private Plaintiff," *Maryland Law Review*, Vol. 32, No. 2, 1972, pp. 91-127.

[297] *Federal Reporter*, 2d Series, Vol. 451, 1971, 3 at p. 6.

[298] *Ibid.*, p. 13.

[299] *Ibid.*, p. 14, n. 18.

[300] *Ibid.*

[301] *Ibid.*, p. 14.

[302] *Ibid.*, p. 16.

[303] *1973 Trade Cases*, Par. 74327, p. 93505.

[304] *Ibid.*, p. 93506.

[305] *Ibid.*, p. 93508.

[306] Arthur D. Austin and Elinor Harris Solomon, "The Antitrust Implications of Compensating Balances," *The Banking Journal*, Vol. 89, No. 8, 1972, p. 706. See also Jerry S. Cohen, "The Antitrust Laws Applied to Bank Mergers, Reciprocity and Tie-in Arrangements," *Business Lawyer*, Vol. 26, September 1970, pp. 1-8.

[307] *1974-2 Trade Cases*, Par. 75153, p. 97172.

[308] *Ibid.*, p. 97173.

[309] This case is discussed in Ted D. Lienesch, "Recent Cases: W.L. Gore and Associates, Inc. v. Carlisle Corp.," *University of Cincinnati Law Review*, Vol. 44, 1975, pp. 141-150.

[310] *1974-2 Trade Cases*, Par. 75420, p. 98387.

[311] *Ibid.*, p. 98390.

[312] *Ibid.*

[313] *Ibid.*

[314] *Ibid.*

[315] *Ibid.*

[316] *Ibid.*, pp. 98390-98391.

[317]*Federal Supplement*, Vol. 386, 1974, 915 at p. 917.

[318]*Ibid.*, p. 926.

[319]*Ibid.*, p. 918.

[320]*Ibid.*, p. 919.

[321]*Ibid.*

[322]*Ibid.*, p. 920.

[323]*Ibid.*, pp. 920-922.

[324]*Ibid.*, p. 921.

[325]*Ibid.*, p. 922.

[326]*Ibid.*, p. 925.

[327]*Ibid.*, pp. 923-925.

[328]*1975 Trade Cases*, Par. 60191, pp. 65650-65657.

[329]*1970 Trade Cases*, Par. 73303.

[330]*Ibid.*, p. 65655.

[331]*Ibid.*, pp. 65656-65657.

[332]*Ibid.*, p. 65657.

NOTES

CHAPTER 7

## RECIPROCITY AND CANADIAN COMPETITION POLICY

[1] Combines Investigation Act, R.S., c. C-23, amended by c. 10 (1st Supp.) c. 10 (2nd Supp.) 1974-75-76, C. 76 (effective January 1, 1976).

[2] Bill C-256, Competition Act, first reading June 29, 1971. 106 pp. Accompanying the bill was "The Competition Act, Explanatory Notes," Ottawa, 1971, mimeo, 130 pp.

[3] Competition Act, p. 40.

[4] Competition Act, p. 36.

[5] Competition Act, pp. 40, 41.

[6] See W.T. Stanbury, Business as an Interest Group in Canada: The Case of Competition Policy, 1971-1975 (Ottawa: Consumer Research Council, forthcoming).

[7] Department of Consumer and Corporate Affairs, Proposals for a New Competition Policy for Canada, Ottawa, November 1973. The Stage I amendments effective January 1, 1976 are discussed in Bureau of Competition Policy, "Background Papers: Stage I Competition Policy" (Ottawa: Department of Consumer and Corporate Affairs, April 1976), mimeo, 78 pp.; W.T. Stanbury (ed.), Papers on the 1975 Amendments to the Combines Investigation Act (Vancouver: Faculty of Commerce and Business Administration, University of British Columbia, May 1976), 187 pp.; Gordon E. Kaiser, "The New Competition Law: Stage 7," Canadian Business Law Journal, Vol. 1, No. 2, 1976, pp. 147-196.

[8] Combines Investigation Act (1976), Part IV.1, pp. 27-32.

[9] Proposals for Stage II legislation are contained in L.A. Skeoch et al., Dynamic Change and Accountability in a Canadian Economy (Ottawa: Supply and Services Canada, 1976); N.J. Williams, "Damages Class Action Under the Combines Investigation Act," and J. Whybrow, "The Case for Class Actions in Canadian Competition Policy: An Economist's Viewpoint," in A Proposal for Class Actions Under Competition Policy Legislation (Ottawa:

Supply and Services Canada, 1976); R.I. Cohen and J.S. Ziegel, The Political and Constitutional Basis for a New Trade Practices Act (Ottawa: Supply and Services Canada, 1976); M.J. Trebilcock et al., Proposed Policy Directions for the Reform of the Regulation of Unfair Trade Practices in Canada, 2 Vol. (Ottawa: Supply and Services Canada, 1976); C.D. Edwards et al. Studies of Foreign Competition Policy and Practice, 2 Vols. (Ottawa: Supply and Services Canada, 1976).

[10] Perhaps the only piece is Donald Eldon's, The Oligopoly Problem in Competition Policy (Ottawa, Economic Council of Canada, 1970, mimeo, 180 pp). He devoted about five pages to the issue of reciprocal dealing (pp. 71-73, 75, 155-156). His discussion cites only a few standard U.S. references (Ferguson, Hausman, Stacking and Mueller and Sichel. See the Bibliography). Only the Waugh Equipment case is analyzed. However, his policy conclusions are of interest. He states:

> On balance then, it would seem wise in legislating restraints on tying and exclusive dealing or related practices [i.e., reciprocity] to make provision for assessing cases on their merits in terms of beneficial or detrimental economic effects. They are too complex to be subject to per se rules, but obviously too important to be free of significant public scrutiny. (P. 75.)

Later Eldon has this to say:

> It therefore seems reasonable to ban reciprocal dealing where, in the relevant market, the buyer accounts for a substantial share of the purchase of a good, or where there is evidence of coercion. In the absence of coercion, it may be desirable to provide for a case-by-case examination of the effect of the practice on competition in the market. (Pp. 155-156.)

A bibliography of materials on the law and competition policy in Canada is W.T. Stanbury, assisted by Charlotte St. Clair and Karen Olsen, "Anticombines Law and Policy in Canada, 1888-1975: A Bibliography," Canadian Business Law Journal, Vol. 1, No. 3, 1976, pp. 352-374.

[11] Submission of Power Corporation of Canada, Limited of the Royal Commission on Corporate Concentration, Montreal, November 14, 1975, pp. 17-18.

[12] Ibid., p. 18.

[13] Ron Huntington, M.P., Submission to the Royal Commission on Corporate Concentration, "A View from the 'Street' on Corporate Concentration and the Public Interest," Ottawa, February 19, 1976.

[14] See the Bibliography at the end of this study.

[15] Huntington, p. 7.

[16] _Ibid_., p. 29.

[17] In the course of a study of the administration and enforcement of the Combines Investigation Act during the period 1960 to 1975 we (Paul Gorecki of the Bureau of Competition Policy is the co-researcher) have examined over 2,300 specific complaints from businessmen, government agencies and consumers. Although 14 per cent referred to trade practices not covered by the Act, not one mentioned reciprocity. If reciprocal dealing by large, diversified firms was foreclosing markets to smaller, more specialized producers, one would expect to hear the complaints of those affected. The silence is deafening.

[18] Bruce T. Allen, "Industrial Reciprocity: A Statistical Analysis," _Journal of Law and Economics_, Vol. 18, No. 2, October 1975, pp. 509, 510.

[19] Jules Backman, "Conglomerate Mergers and Competition," _St. John's Law Review_, Vol. 44, Special Edition, 1970, p. 96.

[20] _Ibid_.

[21] Report by the Staff of the Antitrust Subcommittee of the Committee on the Judiciary, 92nd Congress, _Investigation of Conglomerate Corporations_,(Washington, D.C., USGPO, 1971), p. 2.

[22] See Willard F. Mueller, "The Celler-Kefauver Act: Sixteen Years of Enforcement," in staff of the Bureau of Economics, Federal Trade Commission, _Economic Papers, 1966-69_ (Washington, D.C., 1970), pp. 32-82.

[23] Donald F. Turner, "Conglomerate Mergers and Section 6 of the Clayton Act," _Harvard Law Review_, Vol. 78, No. 7, May 1965, pp. 1313-1395, specifically pp. 1386-1393.

[24] _Ibid_., p. 1394.

[25] _Ibid_., p. 1395.

[26] _Ibid_., p. 1387.

[27] _Federal Trade Commission Decisions_, Vol. 62, 1963, pp. 929-968, specifically p. 952.

[28] See Bibliography for citations.

[29] Turner, pp. 1388-1389.

[30] _Ibid._, p. 1389, emphasis in the original.

[31] _Ibid._, p. 1391.

[32] _Ibid._

[33] The key decision was International Salt v. U.S. _United States Reports_, Vol. 332, 1947, 392, affirmed in Northern Pacific Railway Company v. U.S., _United States Reports_, Vol. 358, 1958, 1.

[34] See the Bibliography for detailed citations.

[35] Cited in Report of the Antitrust Subcommittee, _Investigation of Conglomerate Corporations_, p. 62.

[36] See Phillip I. Blumberg, _The Megacorporation in American Society_ (Englewood Cliffs, Prentice Hall, 1975), Chapter Four, pp. 64-76.

[37] Skeoch et al. (p. 326) state, "We should be very clear about the justification before we impose additional burdens on the business community, especially at a time when it is being urged to become more enterprising and productive...."

[38] See Footnote 10 above.

[39] Skeoch et al., p. 281.

[40] _Ibid._, pp. 42.44, 279-315.

[41] _Ibid._, pp. 43.44.

[42] _1971 Trade Cases_, Par. 73619, p. 90545.

[43] Peter O. Steiner, _Mergers: Motives, Effects, Policies_ (Ann Arbor, University of Michigan Press, 1975), p. 254.

## APPENDIX A

## PRINCIPAL UNITED STATES ANTITRUST STATUTES

### THE SHERMAN ACT[1]

Section 1 -- Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal....Every person who shall make any contract or engage in any combination or conspiracy hereby declared to be illegal shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding fifty thousand dollars, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court.[2]

Section 2 -- Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding fifty thousand dollars, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the courts.[2]

### THE CLAYTON ACT[3]

Section 7 -- That no corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no corporation subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another corporation engaged also in commerce, where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.

No corporation shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no corporation subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of one or more corporations engaged in commerce, where in any line of commerce in any section of the country, the effect of such acquisition, of such stocks or assets, or of the use of such stock by the voting or granting of proxies or otherwise, may be substantially to lessen competition, or to tend to create a monopoly.

This section shall not apply to corporations purchasing such stock solely for investment and not using the same by voting or otherwise to bring about, or in attempting to bring about, the substantial lessening of competition. Nor shall anything contained in this section prevent a corporation engaged

in commerce from causing the formation of subsidiary corporations for the actual carrying on of their immediate lawful business, or the natural and legitimate branches or extensions thereof, or from owning and holding all or a part of the stock of such subsidiary corporations, when the effect of such formation is not to substantially lessen competition.

THE FEDERAL TRADE COMMISSION ACT[4]

Section 5 -- (a)(1) Unfair methods of competition in commerce, and unfair or deceptive acts or practices in commerce, are hereby declared unlawful....

(b) Whenever the Commission shall have reason to believe that any such person, partnership, or corporation has been or is using any unfair method of competition or unfair or deceptive act or practice in commerce, and if it shall appear to the Commission that a proceeding by it in respect thereof would be in the interest of the public, it shall issue and serve upon such person, partnership, or corporation a complaint stating its charges in that respect and containing a notice of a hearing upon a day and at a place therein fixed at least thirty days after the service of said complaint. The person, partnership, or corporation so complained of shall have the right to appear at the place and time so fixed and show cause why an order should not be entered by the Commission requiring such person, partnership, or corporation to cease and desist from the violation of the law so charged in said complaint.... If upon such hearing the Commission shall be of the opinion that the method of competition or the act or practice in question is prohibited by this Act, it shall make a report in writing in which it shall state its findings as to the facts and shall issue and cause to be served on such person, partnership, or corporation an order requiring such person, partnership, or corporation to cease and desist from using such method of competition or such act or practice....

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[1] 26 Stat. 209 (1890), 15 U.S.C.A. §§ 1,2.

[2] In December 1974 the penalties for Sherman Act violations were increased. The maximum fine for a corporation was increased to $1,000,000; the maximum penalty for an individual was made a fine of up to $100,000 and/or imprisonment for up to three years. The offences were changed from misdemeanors to felonies.

[3] 38 Stat. 731 (1914), 15 U.S.C.A. § 18. This section contains the provisions of the Celler-Kefauver Act of December 29, 1950, 64 Stat. 1125 (1950).

[4] 38 Stat. 719 (1914), 15 U.S.C.A. § 45. The phrase "and unfair or deceptive acts or practices of commerce" was added by the Wheeler-Lea Act, 52 Stat. 111 (1938).

## APPENDIX B

### RECIPROCITY CONSENT DECREES 1969-1975

| Name | Date | Citation | Dept. of Justice (J) or Federal Trade Commission (FTC) | Applicable Section |
|---|---|---|---|---|
| United States Steel Corp. | Aug. 25, 1969 | 1969 Trade Cases, Par. 72826 | J | Sherman 1, 2 |
| R.J. Reynolds Tobacco Co. | Sept. 22, 1969 | 1969 Trade Cases, Par. 72886 | J | Sherman 1, Clayton 7 |
| Ling-Temco-Vought, Inc., Jones & Laughlin Steel Corp. and Jones & Laughlin Industries, Inc. | June 10, 1970 | 1970 Trade Cases, Par. 73105 | J | Clayton 7 |
| Inland Steel Co. | July 1, 1970 | 1970 Trade Cases, Par. 73197 | J | Sherman 1, 2 |
| Republic Steel Corp. | July 30, 1970 | 1970 Trade Cases, Par. 73246 | J | Sherman 1, 2 |
| Armco Steel Corp. | Aug. 31, 1970 | 1970 Trade Cases, Par. 73283 | J | Sherman 1, 2 |
| General Tire & Rubber Co., Aerojet-General Corp., A.M. Byers Co. and RKO General, Inc. | Oct. 21, 1970 | 1970 Trade Cases, Par. 73303 | J | Sherman 1, 2 |
| PPG Industries, Inc. | Dec. 9, 1970 | 1970 Trade Cases, Par. 73373 | J | Sherman 1, 2 |
| Bethlehem Steel Corp. | Dec. 11, 1970 | 1970 Trade Cases, Par. 73376 | J | Sherman 1, 2 |
| Kennecott Copper Corp. | Feb. 17, 1971 | 1971 Trade Cases, Par. 73437 | J | Sherman 1, 2 |

Appendix B (continued)

| Name | Date | Citation | Dept. of Justice (J) or Federal Trade Commission (FTC) | Applicable Section |
|---|---|---|---|---|
| Evans Products Co. | Feb. 25, 1971 | 1971 Trade Cases, Par. 73450 | J | Sherman 1, 2 |
| National Steel Corp. | March 29, 1971 | 1971 Trade Cases, Par. 73495 | J | Sherman 1, |
| American Standard, Inc., Kohler Co., Crane Co., Wallace-Murray Corp., Universal-Rundle Corp., Rheem Mfg. Co., Borg-Warner Corp., Briggs Mfg. Co., and Plumbing Fixture Mfrs. Assn. | May 18, 1971 | 1971 Trade Cases, Par. 73549 | J | Sherman 1 |
| Aluminum Company of America | June 28, 1971 | 1971 Trade Cases, Par. 73587 | J | Sherman 1, 2 |
| Reynolds Metals Co. | Aug. 16, 1971 | 1971 Trade Cases, Par. 73626 | J | Sherman 1, 2 |
| International Telephone and Telegram Corp (Grinnell Corp.) | Sept. 24, 1971 | 1971 Trade Cases, Par. 73665 | J | Clayton 7 |
| International Telephone and Telegraph Corp. and The Hartford Fire Insurance Co. | Sept. 24, 1971 | 1971 Trade Cases, Par. 73666 | J | Clayton 7 |
| International Telephone and Telegraph Corp.(ITT Canteen Corp.) | Sept. 24, 1971 | 1971 Trade Cases, Par. 73667 | J | Clayton 7 |

Appendix B (continued)

| Name | Date | Citation | Dept. of Justice (J) or Federal Trade Commission (FTC) | Applicable Section |
|---|---|---|---|---|
| Swift & Co., Armour and Co., Wilson & Co., Inc., and Cudahy Co., et al. | Dec. 20, 1971 | 1971 Trade Cases, Par. 73760 | J | Clayton 7 |
| W.R. Grace & Co. | Feb. 29, 1972 | 1972 Trade Cases, Par. 73829 | J | Sherman 1,2 |
| Jackson's Atlanta Ready Mix Concrete Co., Inc., Jackson's East Point Ready Mix Concrete Co., and Citizens Bank of Hapeville | March 1, 1972 | 1972 Trade Cases, Par. 73827 | J | Sherman 1 |
| Owens-Illinois Inc. | March 1, 1972 | 1972 Trade Cases, Par. 73828 | J | Sherman 1,2 |
| Martin-Marietta Corp. | March 29, 1972 | 1972 Trade Cases, Par. 73858 | J | Sherman 1,2 |
| H.K. Porter Co., Inc. | May 17, 1972 | 1972 Trade Cases, Par. 73917 | J | Sherman 1,2 |
| T.I.M.E. - D.C., Inc. | July 21, 1972 | 1972 Trade Cases, Par. 74069 | J | Sherman 1,2 |
| Westinghouse Electric Corp. | Aug. 1, 1972 | 1972 Trade Cases, Par. 74053 | J | Sherman 1 |
| Uniroyal Inc. | Aug. 15, 1972 | 1972 Trade Cases, Par. 74070 | J | Sherman 1,2 |
| Crane Co. | March 1, 1973 | 1973 Trade Cases, Par. 74329 | J | Sherman 1,2 |

Appendix B (continued)

| Name | Date | Citation | Dept. of Justice (J) or Federal Trade Commission (FTC) | Applicable Section |
|---|---|---|---|---|
| Yellow Freight System, Inc. | March 6, 1973 | 1973 Trade Cases, Par. 74338 | J | Sherman 1,2 |
| United Aircraft Corp. | June 11, 1973 | 1973 Trade Cases, Par. 74467 | J | Sherman 2 |
| The Southland Corp. | Jan. 25, 1974 | 1974 Trade Regulation Reports, Par. 20410 | FTC | not indicated |
| Occidental Petroleum Corp., et al; Diamond Shamrock Corp. | Feb. 7, 1974 | 1974 Trade Regulation Reports, Par. 20520 | FTC | not indicated |
| Grow Chemical Corp | July 29, 1974 | 1974 Trade Cases, Par. 75133 | J | Sherman 1,2 |
| Continental Can Co., Inc. | July 29, 1974 | 1974 Trade Cases, Par 75132 | J | Sherman 1,2 |

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